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Publication No. 69

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CARTEL PROBLEMS

AN ANALYSIS OF COLLECTIVE MONOPOLIES IN EUROPE
WITH AMERICAN APPLICATION

CARTEL PROBLEMS

An Analysis of Collective Monopolies in Europe with American Application

BY

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WASHINGTON, D.C.
THE BROOKINGS INSTITUTION
1935

Set up and printed
Published November 1935

Printed in the United States of America

George Banta Publishing Company

Menasha, Wisconsin

DIRECTOR'S PREFACE

This is the eighth of a series of studies having to do with the National Recovery Administration undertaken by the Institute of Economics under the immediate direction of Leverett S. Lyon. It was Mr. Lyon's belief in planning the series that Americans interested in industrial self-government and in the national government's attempts to determine sound public policy in relation to such efforts would profit by an analysis of European experience in the same fields. This study of cartel problems was, accordingly, undertaken as one of the Institute's series in relation to the National Recovery Administration.

The author of this study, Dr. Pribram, was formerly professor of economics at the Universities of Vienna, Austria, and Frankfort-on-the-Main, Germany, and for seven years was chief of the Statistical Section of the International Labor Office, Geneva, Switzerland. He therefore brings to bear upon the cartel movement a long observation of European economic affairs.

This volume is not a detailed description of cartels in particular industries but an analysis of the economic conditions conducive to the formation of cartels, the attitudes which dominate cartel policy, the various aspects of governmental policy in relation to cartels, and the economic effects of these forms of business organization. In the later chapters attention is given to the similarities and dissimilarities of business and governmental relationships in the cartel movement and under the NRA. Probable lines of future development in the United States are suggested.

Leo Pasvolsky and Harold G. Moulton represented the Institute of Economics in reading the manuscript in an early draft, as did Charles O. Hardy in reading the major chapters in the final draft. Of the group working on the NRA series, Paul T. Homan aided Mr. Lyon in the general supervision of this study and collaborated extensively with the author in giving final form of expression to the work.

EDWIN G. NOURSE
Director

Institute of Economics
September 1935

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INTRODUCTION

Extensive modification of the competitive system by collective combination of business groups is one of the most striking recent developments in economic organization. A vast non-English literature has grown up on this subject, and rather recently several accounts of European experience have become available in English. These studies have been mainly descriptive analysis, giving a highly instructive picture of the institutional characteristics of such combinations.[1]

The present study differs from most earlier studies in certain important respects. It adds little to the descriptive analysis of cartels, or to the elaboration of the special circumstances which have led to local variations in the development of the cartel movement. Rather, it cuts through national differentiating circumstances in the attempt to establish certain widely applicable generalizations concerning the character of the movement as a whole. This line of approach has involved a larger degree of resort to abstract reasoning than is common to general surveys of cartel problems. Without such reasoning it would appear impossible to define the general conditions under which cartelization might be expected to develop or to determine the effects

[1] See R. K. Michels, *Cartels, Combines and Trusts in Post-War Germany*, New York, 1928; R. Liefmann, *Cartels, Combines and Trusts*, 1933 (translation); R. Brady, *The Rationalization Movement in Post-War Germany*, Berkeley, 1933; H. v. Beckerath, *Modern Industrial Organization*, New York, 1933 (translation); H. Levy, *Industrial Germany*, Cambridge, 1935; Patrick Fitzgerald, *Industrial Combinations in England*, 1927; H. Levy, *Monopolies, Cartels and Trusts in British Industry* (2d ed.), London, 1927. Various reports facilitating international comparisons were submitted by distinguished experts to the World Economic Conference held in Geneva in 1927.

on economic life which are likely to result from the typical behavior of cartelized industries.

Special attention has been given to the mutual relations between cartelization and the course of business fluctuations. In pursuing this line of inquiry the facts surveyed led to the conclusion that a clear line must be drawn between "collective monopolies"[2] made up of independent enterprises as represented by cartels, and monopolistic combinations of the corporate type which pursue a unified profit-making purpose. These two general types of combinations have commonly been treated as offspring of the same economic forces antagonistic to the system of free competition. But their behavior appears to be quite different in facing the competitive risks involved in business fluctuations. From a study of the behavior of cartels certain inferences are likely to be drawn—especially as to their probable effects on economic life—which are thought by the author to be applicable to any economic circumstances marked by the generation and maintenance of collective monopolies.

In the last two chapters general considerations derived from European experiences are made the basis for some inferences as to the nature and prospects of recent American monopolistic tendencies. The justification for these inferences lies in the author's assumptions that under the pressure of largely identical general economic conditions phenomena of a specific type and marked by specific features are likely to be produced, and that legislative and administrative policy will sooner or later be obliged to comply with the imperative

[2] The specific meaning attached to the notion of "collective monopolies" as contrasted with monopolies of the single type will become apparent from the following discussion of the nature and policy of cartels.

dictates of this evolutionary process. If the validity of these hypotheses is granted, the main problems at issue consist in adequately defining the general economic conditions underlying the development of cartelization and in assessing the influences exerted by cartels on the economic structure. The present analysis is meant to facilitate insight into these problems, which are closely related to important questions of public policy.

CHAPTER I

THE NATURE OF CARTELS

Since the middle of the last century there has been growing in industrial countries a variety of organizations composed of independent business enterprises created for the purpose of regulating production and sales by combined action. The term "cartels" has been broadly and somewhat loosely applied to these organizations, and their development in various forms has been designated as the cartel movement.[1]

The discussion of cartel problems by scientific investigators, popular writers, parliamentary bodies, and the like has been going on since the beginning of the movement. Nevertheless, as is the case with so many other economic phenomena, the discussion is still in a highly controversial stage. Agreement has not been reached in stating the true nature of cartels, their typical forms, or the influence of the general course of economic events in giving rise to them and in affecting the character of their activities. Their effects—favorable or prejudicial—upon the production and distribution of goods, upon the general economic structure, and upon the distribution of income are variously assessed. Their relationship to the course of the cycles of prosperity and depression has been inadequately examined. And opinions diverge widely concerning appropriate

[1] Dating this movement at the middle of the last century obviously excludes systems of market regulations obtaining prior to the development of modern characteristics of the capitalistic economy.

The reader will understand from the following discussion of the cartel concept and of the main cartel problems the reasons why it would be misleading to consider pre-capitalistic systems of market control as precursors of modern cartelization in spite of certain similarities which can be shown to exist between both groups of phenomena.

public policy toward these monopolistic offspring of violent competition.

Although strongly condemned by fervent advocates of free competition on account of the obvious monopolistic tendencies inherent in concerted action directed toward market control, cartels are considered by those opposed to the doctrine of liberalism to be efficient instruments for superseding the "anarchical" state of competition within the limits of the capitalist economy, and for safeguarding small and middle-sized enterprises against being overwhelmed by the competitive power of large concerns. They are, moreover, regarded by some of their supporters as important means of smoothing out the ups and downs of general business conditions. In a word, they are credited with paving the way for a slow but permanent remoulding of the economic order and for the establishment of a more stable economic system.

Many socialist authors join in the conviction that cartels, comprehensive in scope, might lead to some sort of "organized capitalism," comprising a system of extensive monopolies controlled by the state, which would finally be converted into a socialist economy. Again the Fascist movement, opposed to socialist tendencies, is prepared to consider cartels as adequate means for assisting, in the economic field, the objectives of the "totalitarian state." With a view to unifying all national economic forces in the interests of the state, cartels created primarily out of private initiative are becoming part of the tight fabric of the Fascist administrative machinery and are being made the object of compulsory regulation.

It thus happens that political convictions are more likely to color discussions of the merits of cartels than

is cool economic reasoning. The task of presenting a fairly unbiased picture of this highly controversial subject matter is therefore a rather difficult one. The obvious difficulties are increased by the fact that economic theorizing on cartel problems, almost exclusively pursued by German scholars, was until very recently largely influenced by the historical school of economic thought, which is opposed on principle to free competition and to the methods of economic analysis associated with classical economics. Thus the mounting literature on cartel problems has consisted largely of descriptive analysis which neglected the more fundamental theoretical questions, such as the nature of the monopoly powers exercised by cartels and the changes of economic structure resulting from their operations. More recently such questions have been the subject of closer inquiries, which are, however, not yet sufficient to lay solid foundations for a consistent cartel theory.[2]

The bewildering variety of types of industrial combinations—cartels and others—which have developed in almost all industrial countries is indicative of the forces which are persistently operating towards a slow but far-reaching remodelling of the existing capitalist order. The general tendency underlying this movement may be said to be the same whatever specific forms it may adopt: unlimited free competition is being replaced by common action on the part of the affiliated undertakings with a view to getting control over the market. The degree of market control obtainable under the circumstances of particular industries and the checks set up by legislation or public opinion are, however, extremely variable. These facts account for the multiplicity of

[2] A number of the more important studies of cartels are cited in the footnotes throughout this volume.

types of combinations, each of which is characterised by methods chosen for pursuing specific ends and by lines of policy resulting from underlying economic and legal conditions.

In the midst of this diversity of forms and circumstances, some preliminary analysis is necessary in order to clear the ground for a technical discussion of cartels. It is at the start necessary especially to discover principles of classification by which cartel forms of organization can be distinguished from forms which are not properly so designated. The analysis will start from certain general considerations—rather on the borderline between strictly economic analysis and a more sociological line of approach—which will clarify the motives instrumental in fostering cartel tendencies.

MONOPOLY AND RISK

The system of capitalist economy, as it has developed in the course of recent centuries, is essentially based on the idea of the individual risk. This implies that the consequences of any economic events occurring—for good or for evil—within the individual's sphere are to be put down to his account. In this economic system, there does not exist on principle any factor but the individual himself which might be held directly responsible for the success or failure of the individual's economic activity. The principle, of course, applies not merely to natural persons, but to legally established economic units such as corporations. Individual economic risk-bearing—a fundamental feature of the present economic order—is unthinkable unless backed by freedom of economic action. Thus this freedom is correlative to individual risk-bearing, and logically perhaps even subordinate to it.

In its practical manifestations, however, freedom of economic action ruled by profit-making purposes may assume highly varying forms; and may even tend to the establishment of monopolistic control over the market with correlative minimizing of individual risk. The recent history of economic organization is therefore marked by persistent conflicts between two forms of freedom: freedom of economic action on the one hand, freedom of competition on the other.

Expressed in terms of economic theory, freedom of competition in its perfect realization relates to a market situation in which the quantity of commodities supplied by each seller, out of a given group, covers but a very limited portion of the total demand. Consequently he is bound to supply the largest possible quantity of his output at prices determined by market conditions independently of his will. Any reduction of supply on his part might be covered by his competitors and would in any case but slightly affect total supply; and price increases which he might try to achieve by reducing his output would be easily frustrated or have severely limited effects. Conversely, if supply is largely centralized, that is to say more or less monopolized, it may be regulated in a way to secure prices divergent from those obtaining under free competition. Monopolist policy on principle may be said to consist in regulating production and sales for the purpose of reaping a higher aggregate net return—usually accomplished through a higher differential between costs and prices—than would be possible to the seller who is not in a position to exert a noticeable influence on prices by varying his supply of the goods concerned.

The terms "competition" and "monopoly" do not describe wholly contradictory circumstances, in the

sense that the presence of one necessitates the complete absence of the other. The notions are, it is true, categorically descriptive of contrary or opposing elements in the factual situation. But there exist, in reality, innumerable shades of competitive and monopolistic conditions, and a rigid borderline between the facts to which the two concepts apply can hardly be drawn.

In practice, monopolistic powers of various kinds are efficient instruments in reducing the individual competitive risk and in shifting it to others not equally favored by the chance of getting control over the market. It is thus easy to understand that in almost all spheres of economic life the tendency to establish some sort of monopoly, be it even limited to a very narrow scope and to specific sectors of risk-bearing, is very strong. Unless monopolistic powers can be secured by isolated individual actions, which is very seldom the case, they are attempted by the combined action of those interested, thus amounting to collective monopolies the true nature of which is yet far from being sufficiently analyzed.

This tendency toward combination has been well described by Professor MacGregor as a "revulsion against risk." Since individual risk, with its correlative of economic freedom, is the central characteristic of the competitive system, the mitigation of individual risk with correlative loss of freedom is the central characteristic of schemes for modifying the force of competition. The idea of risk avoidance is therefore generically associated with all phenomena relating to the growth of monopolistic powers. It may usefully be made to serve as the central idea in a tentative classification of types of combination.

THE SCOPE OF THE CARTEL CONCEPT

The immediate task is to delimit the meaning of the term "cartel." This task is made the more difficult because out of an extensive discussion of the subject no consensus has been achieved as to an appropriate definition. Much of the discussion of definitions has centered upon the question whether the idea of monopolistic intent should be made an essential constituent part of the definition. A good deal of ingenuity has been exercised in avoiding reference to monopoly, particularly on the part of those who believe efforts to limit competition to be beneficent in their effects. Historically, monopoly is a word with many invidious connotations, often implying the exploitation of the economically weak by the economically privileged. On this account some writers prefer to avoid it.

How far the attempt to avoid references to monopolistic tendencies may lead is illustrated by the definition adopted by an international committee set up by the League of Nations: "Cartels are associations of independent undertakings in the same or similar branches of industry established with a view to improving conditions of production and sale."[3] Such a definition has certain serious shortcomings. The word "improving" is ambiguous, failing to report to whom the improvement accrues, whether merely to the members, or to the industry at large, or to economic society. Moreover, and more important as an example of definition, it is so broad in scope that it makes practically impossible any distinction between cartel type and non-cartel type business associations. It applies with equal accuracy to the usual types of American trade association—in-

[3] *General Report on the Economic Aspects of International Industrial Agreements*, Ser. L. o. N. P., 1931, II, B, 21, p. 8.

terested perhaps in standardization of products, improved accounting methods, or exchange of business information—to price-fixing groups, and to highly developed monopolistic combinations for dividing the market.

A definition centering on the exercise of monopolistic powers for the control of the market comes nearer to isolating characteristic elements for the definition of a cartel.

It might be thought possible to classify associations according to the degree of loss of freedom by the members, and by more or less arbitrary choice to isolate those marked by a fairly high degree of collective monopolistic action and to call them cartels. The test of a cartel would then be a certain degree of monopolistic power. The difficulty with this approach is that it assumes the possibility of reducing all forms of monopolistic action to some common mode of quantitative measurement. The fact is, however, there are different *kinds* of collective action adjusted to different kinds of market control.

The very diversity of the forms and degrees of monopoly power makes some further breaking down of the monopoly concept necessary, if an attempt is to be made to give more precision to the cartel concept. The immediate problem therefore is that of examining the means utilized in the exercise of market control, and deciding to which ones among them the cartel concept shall be applied. Somewhat tentatively, it is here suggested that progress toward a more illuminating definition of cartels can be made through resorting to the risk concept and examining the means of collective action for the avoidance of risk.

At the very start it may be understood that further

analysis will be limited to business associations in which the avoidance of risk (or, as the case may be, the exploitation of profit-making opportunities) is sought through means which place substantial limitations upon the freedom of members in relation to their markets. Trade associations of the typical American varieties are thus excluded. Such associations, it is true, are organized on the principle of common interest in given markets. Their activities, whether in promoting cost accounting, lobbying for tariffs, advertising industry products, promoting trade ethics, or compiling statistical data, are almost uniformly designed to promote the interests of members in the markets in which they sell. In that sense they are designed to mitigate the risks of competition. Operating as they do, however, under the legal limitations of the anti-trust laws, they place no formal restraint whatever upon the economic independence of their members. Their existence therefore presents to no individual member of the industry any guaranty of mitigation of his own particular risks.[4]

An orderly insight into the methods of collective business action will be much facilitated by distinguishing two primary aspects of economic relationships. One of these is the field of pecuniary, or price, relationships. The complex of such relationships may be called, for want of a better phrase, the "money exchange system." The other is the field of physical production and distribution of economic goods. The complex of relation-

[4] Also excluded, because falling outside the parlance of cartel discussion, are employers' associations designed for common action in dealing with the labor market; trade unions designed to effect some control over the labor market in the workers' interest; agricultural associations, co-operative or otherwise; and co-operative or other associations of purchasers. It may be mentioned that some German authors speak of "purchasers' cartels," but this usage is likely to impair the establishment of a clear cartel concept.

ships in this field may be termed the "real exchange system." The two sets of relationships are of course equally necessary elements of actual economic processes under a capitalistic economy—two sides of the coin. They are, however, logically distinguishable. And indeed the distinction is essential to thorough insight into the character of industrial combinations.

It is obvious that the members of an industrial combination may enter into agreements with one another strictly limited to the money exchange system. Such agreements may cover selling prices and related terms of sale, methods of computing costs, and other matters relating primarily to the pecuniary aspects of doing business. On the other hand, agreements may relate strictly to the real exchange system, covering use of productive capacity, agencies of distribution, geographical division of markets, and so on. Or the agreement may cover both fields.

The significance of this distinction may best be seen in terms of risk. It is characteristic of the former (the money exchange) category of agreements that, while the parties to such agreements are provided with some protection against the unregulated movement of prices in the market, they are guaranteed no place in the market. With respect to the actual control over the use of their productive plant their freedom is as unrestricted as ever. No provision is made to insure that each party will continue to share in the privilege of supplying the market within even the widest limits of variation.

The essential nature of agreements or combinations in the other (real exchange) category is to ensure to the members some participation in the market. Whatever the exact methods or procedures followed, the underlying thought is that of allocating shares of participa-

tion in a market which is thought of as a single unit, limited in extent and capable of being divided among members.

In popular speech collective agreements in both the fields mentioned have commonly been called cartels. For reasons which will be more fully developed at later points, the term "cartel" will be confined in the following pages to forms of collective organization which cover operations in the second, or real exchange, field, whether or not they also cover operations in the first, or money exchange, field. It is only with respect to controls exercised over actual productive and marketing operations that any boundaries can be found for the cartel concept to prevent its generic meaning from applying to all the myriad forms of the monopolistic tendency in modern industrial organization.

A distinctive feature of both cartels and other more or less monopolistic associations is that the several members retain their separate identity and financial independence. Back of all their activities, therefore, lies the possibility of eventually being thrown back into unsupported independence in an open market. In this, all such combinations are to be contrasted with financially unified or interconnected enterprises such as consolidations, holding company groups, close communities of interest, or other forms of combination marked by permanent loss of independence on the part of the constituent members and by the establishment of unified risk-bearing. The latter types will never be the focus of attention in this present study, but will be called upon from time to time to serve as points of contrast.

Before proceeding to a fuller description of types of combination, it will be well to note that we now have before us four large groups or categories: (1) ordinary

trade associations involving no loss of freedom of action by members and little trace of monopolistic powers; (2) associations marked by agreements among the members with respect to their pecuniary relationships with the market in the money exchange system; (3) combinations marked by agreements concerning producing and marketing activities within the real exchange system; and (4) combinations in which the separate enterprises have lost their identity or financial independence. The first and fourth of these groups are not here under discussion. The second and third groups, to both of which the term "cartel" has been applied, will be further examined in the following chapter, being subdivided into types of association for the purpose of displaying the typical methods of collective monopolistic action and collective avoidance of competitive risks. Thereafter the discussion will be almost wholly confined to the third group, which is conceived to constitute the substance of the cartel movement, properly so-called.

The principle governing the larger classification serves two special functions which are of use in examining the economic significance of cartels. It permits certain distinctions to be made between methods of mitigating economic risk. And it permits combinations to be examined according to their fundamental relations to the two main features of general market conditions: expansion and contraction.[5]

CARTELS AND BUSINESS FLUCTUATIONS

The amazing variety of agreements, associations, and combinations tending to modify the competitive risks of individual concerns is not capable of explanation in any simple or general terms. Peculiar elements in the

[5] It may be mentioned that the same principle of division could be made applicable to a general classification covering all organizations which, in one way or the other, are intended to promote economic interests of their members.

structure of particular industries, technical developments, special features of the market, personal factors, legal regulations, and so on, in their several ways influence the character of collective or combined action. Back of these unique influences it is, however, necessary to search for general influences affecting the trend of developments.

The combination movement, in so far as that phrase refers to the emergence of large-scale business units, is in a general way traceable to technical changes in production and transportation, with their direct effects upon the costs and economical size of business units and their collateral effects upon the character of products, markets, and forms of financial control. Monopolistic developments on a large scale are derivative not merely from the rise of favorable opportunities for market exploitation which develop in connection with large-scale enterprise, but also from special problems connected with dynamic changes of industrial structure and changing conditions affecting wide markets.

In the literature of the combination movement the character of the changing technical and market conditions, and the foundation and forms of monopolistic developments, have been widely discussed; and such discussion need not be repeated here. In all this discussion, however, comparatively little attention has been given to the cyclical fluctuations of business conditions in relation to the forms of business co-operation and combination.[6]

[6] In the present discussion, regardless of the various theories advanced for explaining the causes and the trend of business fluctuations, the concept of such fluctuations will be interpreted in a very broad sense so as to embrace any recurrent general changes in trade conditions marked by the alternation of expanding and contracting markets, expansion being, as a rule, accompanied by rising, contraction by falling, prices.

Since cyclical movements are, up to the present, an essential feature of capitalist economy wherever and under whatever circumstances it has developed, the behavior of cartels during the different phases of this movement ranks with the foremost problems to be examined if an adequate understanding of the development and the policy of cartels is to be arrived at. Such fluctuations pervasively change market conditions, and *a priori* it is to be supposed that the occasions, motives, and forms of collective action will be different in the face of unstable markets from what they would be if economic conditions were highly stable. It is equally reasonable to suppose that, under unstable conditions, motives, forms, and policies will all be affected by whether market prospects are promising or the contrary. Objective study confirms this supposition.

Instability may be either special or general. That is to say, special circumstances affecting a given industry may create instability within it, regardless of general economic conditions. Such circumstances may be illustrated by a permanently declining market due to any of a number of reasons; or by very rapid expansion of productive capacity outrunning the growth of profitable market demand. General instability primarily arises from circumstances which center in the credit and financial mechanisms of a capitalistic economy, and affect the market prospects of all industries alike, for good or ill.

Business motives may be expected to be substantially similar in the face of market declines or improvements, respectively, regardless of whether the causes are special or general. The recurrent cyclical fluctuations do, however, have far more pervasive effects, and afford a better opportunity to study in an extensive way the effects of

unstable market conditions upon the motives leading to business combinations, the forms they take, and the policies they follow. The analysis in this study is therefore based upon the phenomena of general fluctuations, in so far as the latter affect the development of specific types of combinations. But it is to be understood that the analysis is under special circumstances equally applicable to particular industries, irrespective of the existence of general movements toward depression or prosperity.

To the effect of cyclical fluctuations upon ordinary trade associations and voluntary price-fixing associations no particular attention will be given. Such associations are, as a rule, so loose in character and the obligations they impose on their members so restricted in nature that it seems hardly necessary to enter into a detailed study of their behavior and of the effects they may exert on the structure and development of the economic system. Moreover, when examined as to their relations to business fluctuations, they may be termed "neutral" in the sense that their creation and development may be fostered, as the case may be, by expanding as well as by contracting markets, though their policy is bound to vary according to changing market conditions. The more contraction of demand is instrumental in their establishment, the more they are likely to attempt a strict control of prices and other selling terms, and even of the general relations of their members to the market.

The center of interest at this point is in the analysis of the policy of cartels (as defined above) in relation to fluctuations, contrasted in some of its essential features with the behavior of large corporate combinations.

Broadly speaking, as has been seen, cartels are com-

binations of independent producers or sellers of raw materials or manufactured commodities established with a view to limiting the individual risks involved in their business activities by controlling the markets of their products. The apparent advantages resulting from such forms of common action make themselves strongly felt when producers are faced with a dim outlook on a market which is supposed to be, for an indefinite time to come, out of proportion with the total productive capacity of the trade; and when there exists, on the other hand, a reasonable chance, by concerted proceedings, to avoid common disaster ensuing from destructive competition.

It is evident that under such conditions unlimited application of individual risk-bearing is very burdensome. The flight of capital from one line of business to another which might prove more profitable is, as a rule, out of the question. Under a system of free competition decreasing demand will force prices down thus driving weaker competitors from the market and automatically reducing the existing sources of supply. Adaptation of costs to prices is the prime motor tending to re-establish the equilibrium. But the functioning of the price-cost mechanism is seriously impaired by heavily falling prices in lines of trade in which large fixed capital investments and, consequently, large general (overhead) charges play an important role. Such charges remain relatively constant in spite of changing output and their amount per unit of output increases as output is reduced. The effort to reduce costs by attaining larger volume involves a continued downward tendency of prices to the detriment of all competitors. From the business man's point of view the situation is analyzed as "over-production" in relation to the existing market

situation, and "over-capacity to produce" is regarded as the underlying maladjustment.

Under such conditions prices resulting from free competition, being below cost, are contrary to the principle fundamental to the functioning of capitalist economy. Given time, a new profitable cost-price equilibrium may be expected. Meantime, however, a strong incentive exists to secure by common action prices which will permit production without losses. This incentive is the greater, the heavier the fall of prices and the more prolonged its duration.

The fundamental importance of the risk problem for the development of cartelization was clearly recognized by R. Liefmann, one of the leading German experts in this field. "Cartels," as he has it, "are generated by the increasing divergence between the risk involved in heavy capital investments and the ensuing profit." Of course "profit-making" takes a specific aspect if viewed from the angle characteristic of cartelization.

Another student of German industrial organization writes:

> The only price doctrine which can be detected as influencing the combination movement in Germany as contrasted with the United States is the belief that an industrial undertaking ought to earn a normal rate of profit. Study of the combination movement in almost every industry suggests that a point comes in its history when the incentive to maintain profits at their previous level is strong enough to outweigh the factors which previously hindered combination. The date at which this point is reached depends on the structure of the industry; the capital intensive industries reach it first.[7]

Something similar to the old idea of the *justum pretium* (legitimate price) is invoked.

[7] D. Warriner, *Combines and Rationalization in Germany*, p. 102.

There can hardly be any doubt that periods of heavy trade depressions were especially instrumental in fostering the cartel movement, in particular those forms of cartelization which in the first instance attracted public attention and scientific research. For reasons connected with the character of their products and of their costs, mining and heavy industries took the lead in adapting output by common agreement to the limited demand of the market. But wherever the cartel movement gained a firm footing it rapidly spread, with varying success, over a large range of different trades, and we may observe the peculiar phenomenon that in periods of upward cyclical movements, genuine and free competition often exists in an industry which turns during a depression period to open or secret agreements in order to check the adverse effects of contracting markets.[8]

Just as conditions consequent upon heavy and lengthy depressions of markets promoted the development of cartels, opposite conditions, resulting in the bright outlook on rapidly expanding markets and adequate credit facilities, were conducive to the development of entirely different types of combination. These are characterized by the establishment of *unified* risks created by merging the individual risks of independent concerns into economic or financial units, such as trusts, holding companies, outright consolidations, communities of interests. This view is confirmed by the researches that have been made into developments in several countries.[9]

[8] O. Morgenstern, "Free and Fixed Prices," *Harvard Business Review* October 1931, p. 65.

[9] Professor Myron W. Watkins reaches the following conclusion concerning American experience: "In short, the relation of the industrial combination movement to the course of business activity leads to the conclusion that

The contrast thus made is not to be regarded as universally applicable or free from exceptions. It will, for example, be shown later in the historical survey of the German combination movement that under specific conditions certain types of unified combination have been fostered by depressed markets. But in a general way it would be impossible properly to interpret the characteristics of the movement, and in particular the timing of the creation of combinations, without making the contrast. The creation of combinations which involve loss of financial independence on the part of the combined enterprises usually requires favorable market and credit conditions as a constituent circumstance. On the other hand, collective agreements which necessitate dividing the market between weak and strong alike arise peculiarly from motives which are accentuated by the existence of depressed markets.

The tendency to get control over the market by restricting competition is inherent in the very nature of cartels and closely bound up with their ultimate objectives which consist in reducing the individual risks of their members by creating some sort of collective means of equalizing and reducing competitive risk. Combinations not marked by this tendency ought not to be called cartels. The same tendency may be very strong in determining the development of unified combinations, but failure on their part to secure market control is not, as with cartels, detrimental to their existence. The risks to be avoided are mainly those arising out of competition under unstable economic conditions. The importance of connecting each of the

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the trusts were formed primarily as a means to the more rigorous exploitation of favorable business opportunities." *Industrial Combination and Public Policy*, 1927, p. 44.

alternative features of market conditions with the generation of a group of combinations marked by specific characteristics will be shown in analyzing the behavior of the various types of industrial combinations.[10]

[10] In the appendix an attempt has been made to survey the development especially of the German combination movement with a view to determining the influence exerted on this development by alternate expansions and contractions of the market.

CHAPTER II

TYPES OF COLLECTIVE MONOPOLIES

The attempt made above to classify industrial combinations—in the broadest acceptance of this term—was based on an insight into the varying means adopted with a view to modifying the individual risks of the concerns included within the combination. This grouping as contrasted with other classifications suggested by various authors may claim the merit of being based on a single principle of division which, moreover, is likely to facilitate the study of some of the primary problems presented by the functioning and the development of industrial combinations.

The subclassifications as given in the following analysis are designed to display the more specific objectives and methods of industrial combinations, and variations in the attempted degree of market control.[1]

It is hardly necessary to add that the classification thus arrived at cannot pretend to be exhaustive. Eco-

[1] Various classifications have been proposed, especially by German authors, but it would hardly serve the purpose of the present analysis to enter into a discussion of their merits, the less so as they differ rather as to the arrangement of the main groups than as to the types distinguished. Differences of opinion mainly turn on the question of how to define the boundary lines between cartels strictly speaking and other forms of associations the monopolistic tendencies of which are not clearly accentuated; or, on the general grouping of cartels—whether their objectives rather than the main methods adopted are to be made basic to the classification, and whether an adequate grading of the types might be attained by distinguishing adequate degrees of intensified machinery used for cartel purposes. The differentiation by types was especially elaborated by such experts as R. Liefmann, *Cartels, Combines and Trusts*, 1933, and S. Tschierschky, *Kartellorganisation*, 1926. In discussing the different types of cartels the author was especially assisted by the latter book, which is based on vast experience and is remarkable for the searching examination of the problems involved. See also H. v. Beckerath, *Modern Industrial Organization*, 1933, pp. 213 ff.

nomic life is prodigal in creating a vast variety of forms of combination. Any day may bring about new variations; transitional features and mixed forms may exist between the types established. Such a situation is no cause for wonder in an unstable economic world marked by constantly changing conditions and incessant attempts to cope with the difficulties created by domestic and foreign competition. But such facts need not impair the validity of a classification which is only a preliminary instrument for approaching an understanding of the general conditions under which the most important types of combinations developed, of the policies adopted by them in order to attain their essential objectives, and of the effects they exert on the structure of the economic system.

ASSOCIATIONS NOT STRICTLY OF CARTEL TYPE

Under this heading will be described typical organizations for promoting collective agreement with respect to relationships in the money exchange sphere. Combinations of this kind—found in almost all countries—are characterized by the fact that the independence of their members is rather fully preserved. Consequently combined action, though tending to modify individual risks of members, is narrowly limited in scope as well as in efficiency. Agreements instrumental in creating such combinations are rather easy of acceptance by a large majority of an industry whenever the sense of mutual interest has developed even in a minor degree. Though this development may be fostered by conditions of violent competition, such combinations are not particularly an outcome of depressed market conditions. They may also make their appearance in periods of expansion if by concerted action prices may

be increased or barriers to the realization of profits removed.

Numerically, associations of this kind form the bulk of the entire movement toward collective agreements for market control; but their importance, measured by the effects they may exert on the structure of the economic system, is hardly proportionate to their number. The less the independence of the members is interfered with, the more easily their policy can be adapted to changing conditions. On the other hand, the existence of such associations is very often rather unsteady, since strict observance of the obligations can hardly be secured whenever it is likely to become prejudicial to the interests of any of the members.

The various types of association are described below in terms of their primary means of price control. This does not mean, of course, that they may not engage in activities of other sorts such as industrial research, collection and analysis of industry statistics, and so on. The sole activities in view in this discussion are, however, agreements designed to effect some degree of collective control over the market.

Selling-Terms Associations

Agreements of this type are designed to establish binding regulations covering the terms of sales contracts. Such regulations may cover a wide range of subjects. Quite commonly they make provision for preventing subsequent concessions or deviations with respect to the quantity and quality of goods ordered; for defining ways and conditions of delivery, packing, shipping, and insurance; and for establishing standard terms of credit, means and modes of payment, discount arrangements, and so on.

Some of the regulations are directed against abuses falling in the category of unfair practices, such as malicious refusal of delivery or the taking of increased discounts. Their main purpose is, however, to charge the commerce—instead of the industry—with the risk of keeping sufficient stocks and to reduce producers' risks involved in granting credit to dealers.[2] Adoption of rigid terms of credit and payment may even result in influencing the price system and business activity as a whole.

Combinations of this type are especially adapted to the needs of trades in which competition is very strong among a large number of small or medium size establishments producing specialized commodities which do not lend themselves to price-fixing—conditions characteristic, for instance, of the clothing and foodstuff industries, and other lines of finishing industries. The superior bargaining power of the buyers which might succeed in turning essential selling terms to the prejudice of the sellers is met here by combined action on the part of the latter.

While agreements of the sort described represent almost no attempt at monopolistic control over the market, in operation they often tend toward further developments in that direction. Since prices as such are not interfered with, buyers, especially wholesale dealers, tend to exercise pressure to secure price concessions. When in competitive markets the tightening up of other selling terms is offset by far-reaching discrimination in the prices charged by the sellers, the efficiency of the system is likely to be impaired. Against this tendency informal understandings as to prices may be resorted to

[2] For a more detailed analysis of the methods adopted by selling-terms associations, see B. Burn, *Codes, Cartels and National Planning*, 1934, p. 197.

on the part of the members of the combination as an expedient for fortifying the agreement.

Provisions prohibiting guaranties against price declines from being included in sales contracts have some effect in supporting prices in periods of falling prices so long as old contracts are still running. On the other hand, price increases may be more easily put into effect if the selling terms exclude so-called "options," that is to say, the buyer's right to place additional orders after the expiration of the original contract at the terms previously agreed upon.

Not infrequently the dependency of the buyers upon the sellers is increased by additional stipulations such as tying contracts or exclusive trade agreements, under which buyers are required to buy solely from members of the association.

In Germany combinations of this type played a very important role during the inflation period by successfully shifting to the consumers the losses arising from the rapid depreciation of the currency. The violent reproaches launched against "cartels" during that time were, as a matter of fact, largely directed against selling-terms agreements, since true cartels were practically non-existent, or at least moribund.[3]

Under stable currency conditions selling-terms agreements may prove prejudicial to business activity and to recovery from depression by unduly restricting credits which otherwise might be granted the customers and by excessively standardizing the selling terms. Moreover, the costs involved in safeguarding, by means of a cumbersome control machinery, the strict observance of the obligations entered into by the associated concerns, are relatively considerable.

[3] See p. 255.

Price-Fixing Associations

The most important selling term is, of course, the price charged for a commodity, and many term-fixing agreements have been but first steps on the way leading to the formation of price-fixing associations. Such associations establish the obligation to observe fixed minimum price limits, with additional provisions to prevent prices from being undercut by modifying terms of delivery or of payment and credit. Though it has become common usage to speak of "price cartels" in denoting any combinations created for price-fixing purposes, this term is not adopted in the present analysis.

Owing to the loose nature of such associations, even quite informal understandings, commonly called "gentlemen's agreements," may serve their purposes. This is especially the case in countries in which price-fixing agreements are either not enforceable at law or are declared unlawful. Wherever such agreements have been enforceable at law, as for instance in Germany, written form of the agreement has been made a condition of its validity.

Since the members of price associations are expected to secure prices which will at least cover costs and some profit, the minimum prices fixed, which are likely to become uniform prices, tend to be adjusted to the costs of marginal or high-cost producers. The members producing at lower costs will reap differential profits which are likely to be used in part for improving and extending their establishments, thus strengthening their superiority over weaker competitors. But it follows from the very fact that the calculation of minimum prices is based on some kind of cost accounting that a fairly narrow range of disparity of costs among the members is indispensable for the creation of such an association.

Therefore price-fixing associations are less applicable to industries in which technical improvements may permit rapid and far-reaching reductions of costs, or in which sales are largely affected by fluctuations of the market, or in which costs of raw materials and other means of production are highly variable. Consequently the development of such associations was facilitated, in many countries, by the increasing tendency of wages to be ruled by collective agreements, whereby inequalities of cost due to differences of the respective payrolls were somewhat levelled out. Standardization of products, connected with the rationalization movement, was equally helpful, though of course the primary purpose of standardizing the form and general quality of the articles included in uniform price lists was to reduce costs of production.

If prices and other important selling terms are fixed by virtue of the agreement, competition will largely center on quality of the produce and adjustment of the conditions of delivery to the special needs of the consumers, or on the arts of salesmanship.

Since as a rule the procedure of price-fixing is rather cumbersome under the more primitive types of price-fixing associations, attempts to change the prices agreed upon commonly meet with difficulties and delays. Because of this rigidity of fixed prices and because the losses resulting from diminished sales may hit various groups of producers with very different force, price associations in many industries are very vulnerable to reduction of demand in periods of a general fall of the price level. Thus the existence of price-fixing associations is put under a heavy strain by a rapidly declining general level of prices and by changes of important cost elements not equally spread over the combined under-

takings. In many cases, therefore, price-fixing agreements have been preparatory to the creation of true cartels, under which more stable collective forms are established for meeting the risks of operating in unstable markets.

Paper, textile, ceramic, and other industries producing bulk articles are industries in which the simpler types of price-fixing associations have played an important role in Germany. The French "associations commerciales," the development of which dates back to the beginning of this century, are in general to be regarded as of this type as far as they do not belong to the category of open-price associations.

The difficulties inherent in the somewhat rough-and-ready methods of price-fixing used by many associations have led to attempts to refine the methods. The initial step is that of introducing refined methods of uniform cost accounting. These may be made the primary basis for price determination without agreements definitely fixing minimum prices. Or they may serve as the basis for such collective agreements.

Cost accounting associations. Calculations of cost of production for establishing some uniformity in the methods of arriving at price quotations are made the essential object of binding agreements by cost accounting associations. These developed especially in Germany after the World War, owing to the experiences during the inflation period. The more rapidly the purchasing power of the currency is changing, the more are producers misled into errors in assessing the cost elements of production. Under-estimation of costs, though on a smaller scale, is equally frequent under more stable monetary conditions if the market is the scene of violent competition. To avoid underselling damaging to all

competitors, uniform cost accounting systems are prescribed, the parties to the agreement assigning each cost element an adequate place in the schemes established. Fixed and variable elements are clearly separated, and standardized methods of calculations are provided for. Certain overhead charges and profit margins as a rule are expressed in fixed percentages of the amount of current variable cost elements.[4]

The agreement entered into by the associated firms is to the effect that no enterprise is to sell its products below its own costs as computed by the accounting methods agreed upon. Non-compliance with the agreement is penalized by fines. Though the prices to be charged to the consumers are left to the discretion of the members, a certain degree of price-fixing is likely to ensue, in so far as the elements of current costs of production are about the same over the trade. Associations of this type have developed in Germany, especially in industries which produce a wide variety of commodities not lending themselves to standardization, and in which the amount of fixed capital costs is relatively small, the size of the establishments not considerable, and undercutting of prices very frequent.[5]

The policy adopted by the code-making authorities under the National Recovery Administration was largely influenced by similar considerations. The difficulties experienced in establishing adequate cost ac-

[4] Thus the members of an important German cotton spinners' association entered an agreement in 1926 with a view to establishing periodically fixed proportions between the prices quoted for the raw materials and the prices to be charged for the products of the trade yarns and tissues. The proportions are expressed in terms of the costs involved in working up the materials. See *Ausschuss zur Untersuchung der Erzeugungsund Absatzbedingungen der deutschen Wirtschaft*, Berlin, 1930, Vol. I, Sec. 3, Teil II (Textilindustrie), Teil B, p. 272.

[5] Such agreements have existed, for example, in the silk-weaving and china manufacturing industries.

counting schemes increase to the extent that the essential elements of cost differ among competitive concerns.

Associations for price-fixing based on cost accounting. If the idea underlying the establishment of cost accounting schemes is applied to the purpose of getting a sound basis for price-fixing, a modification of price-fixing associations is effected. Associations of this kind are superior to simple price-fixing associations in so far as the prices made binding upon the members are arrived at by carefully comparing detailed information supplied by the members. The weakness of price-fixing based on uncontrolled data concerning current or average prices is avoided. Thus, apart from the advantage of establishing efficient methods of cost accounting, associations of this type are in a position to adapt prices more easily to the fluctuations of the variable cost elements of production. Moreover, careful differentiation of prices according to qualities is more likely to result from the application of sound methods of cost accounting. In this connection, specific difficulties are very often encountered in allocating the item "overhead charges." In some cases the expedient of grouping the concerns by classes has been resorted to, thus arriving at the establishment of a list of prices which, as far as possible, is graduated according to quality.[6] This may, however, produce a differentiation of prices resulting in increased divergencies of the sales effected by the various classes of producers. Methods for remedying this development lead in the direction of setting up a cartel, and are characteristic of a specific cartel type to be discussed later.[7]

In spite of incessant endeavors made by many Ger-

[6] See S. Tschierschky, *Kartellpolitik*, 1930, p. 77.
[7] See p. 41.

man industrial associations to have crude forms of business management improved by well elaborated methods of cost accounting and by rationalization, relatively little progress has yet been achieved along this line. Most enterprisers are reluctant to supply, for price-fixing purposes, accurate statements of their costs of production which might permit competitors to find out carefully guarded managerial or technical secrets.

Associations for the Protection of Privileged Prices

There remains to be mentioned, more for the sake of completeness than for its economic importance, a specific type of price association created with a view, not to price regulation or price-fixing proper, but to protecting prices based on partial monopolies of special character, especially such as are due to trade-mark systems. Contracts stipulating resale price maintenance are, as a rule, entered into by the producers of trade-marked commodities and their customers. Failure to secure strict observance of these contracts may result in shattering the privileged position of the producers which is largely based on the fact that each article is being sold throughout the market concerned at a uniform price. Thus the common interest of producers of such commodities is instrumental in the formation of associations providing for mutual obligation of their members to include maintenance of prices fixed by them in the selling contract, and to apply measures of boycotting against dealers who do not comply with such terms. So far as the agreements merely limit practices which may be characterized as unfair trade practices they are outside the scope of the present analysis. On the other hand, the methods of price maintenance and

the terms to be included by common agreement of the producers in the selling contracts may take forms which are to be considered as abuses of the quasi-monopolistic position granted by the law through trade-marks, copyrights, and patents.

GENERAL CHARACTERISTICS OF CARTELS, STRICTLY SO-CALLED

For defining the boundary lines to be set up between cartels and other forms of collective business organization, the former have at an earlier point (page 14) been characterized as exercising some form and degree of control over the activities of their members in the real exchange sphere. Special stress is to be laid on the fact that cartels are generally ruled by the idea of the overcapacity of an industry to supply the needs of its market, and of the need for collective regulation of production, if operations are to be maintained on a profitable basis. This idea underlies the often quoted saying that "cartels are children of necessity," and the statement, made in 1896 by Schoenlank, that the natal hour of continental European cartels can be definitely established as the black day of the famous crash of 1873.

In so far as cartels are intended to become, or turn out to be, permanent institutions, the primary idea instrumental in their creation is extended to include the view that there exists a lasting tendency for the output capacity of the industry concerned to outrun the demands of the markets which can be met at prices consistently above the costs involved in the productive process. Since such costs are least capable of being rapidly adjusted to changing market conditions in industries where fixed overhead (especially capital) costs and transportation costs are of large relative importance, the field in which true cartels have found their

widest and most striking application is the market of basic materials and heavy industries.

Under the idea fundamental to cartelization, a given market clearly defined in scope—as a rule a national or regional one protected against outside competition by duties, freightage, or other cost elements—is considered as a whole, and compared with the productive capacity of the trade, also looked upon as a whole. This comparison is made with a view to determining the quantity of output which can be sold on this market at profitable prices. To put it in other terms: Some concept of pooling in the strict sense of this expression, involving the creation of some sort of collective means of risk-bearing, is inherent in the nature of cartels.[8] The establishment of such collective means is paralleled by attempts to create collective monopolies. Producers pledge themselves to abandon free competition—a fact which may be concealed from customers by various practices if this is likely to serve cartel purposes.

As long as free competition is operative, old works producing at relatively high costs are constantly supplanted by new or rehabilitated ones which are better equipped and in a position to operate profitably at lower prices, or it may be with superior qualities. In prosperous periods when the output of low-cost firms is not sufficient to cover the entire demand, firm or rising prices may guarantee the solvency, or even profitability, of the so-called marginal producers operating their establishments at relatively high costs. The decisive juncture is marked by the turn from prosperity

[8] American authors are inclined to give the term "pool" a much broader application, covering any agreements providing for restriction of competition as to prices, markets, and production, or even for an interchange of patent rights. In order to avoid confusion the expression "pool" is not used in the present analysis.

to depression. Marginal producers anxious to meet the competition of their more efficient rivals are forced to take resort to the policy of underbidding by neglecting the cost element involved in their capital investments, that is to say by "decapitalization" of their plants. This may happen in any degree, going so far in extreme cases that only the direct expenses may be covered by the prices. It is to such situations that the phrase "cut-throat competition" is applied.

The larger the capital invested in the undertakings, the more persistent this struggle for existence is likely to become. Thus some branches of mining and heavy industry, being highly sensitive to business fluctuations on account of their degressive costs, are likely, in periods of contracting markets and under conditions of free competition, to be the scene of violent and long continued competitive struggles.[9] This is exactly the situation which is likely to prepare the ground for common understandings as to market regulations. Steps toward such collective action are especially characteristic of depression periods, and, as some observers are inclined to believe, are more likely to occur in the middle or later stages of depression periods rather than at their beginnings. The idea underlying the agreements between the competing concerns is primarily that of stabilizing, as far as possible, the competitive conditions obtaining at the time the agreement is made;

[9] Because of the varied meanings given to the general term "decreasing costs," it seems appropriate to apply the rather unusual expression "degressive costs" in order to characterize the specific situation of industries in which large fixed capital investments and, consequently, large overhead charges result in reducing costs per unit of output up to the point where the optimum in utilizing plant capacity is attained. Under these conditions, adaptation of output to restricted markets and falling prices is made more painful by the tendency of costs to rise along with reductions of the volume of production.

that is to say, to stop the process of supplanting the less efficient undertakings by the better equipped ones.

The idea of a given market's being a kind of unit to be divided among producers and dealers may take different aspects. Two main features are to be distinguished here. The concept of unity may be applied to the total amount of production or sales, adequate quotas of which are to be apportioned to the members of the agreement. As either an alternative or a supplement to such agreements, the division of the market may be made on regional or allied lines, each member or group of members being allotted definite portions of the market. This distinction is fundamental in classifying the different types of cartels.

The nature of the market on the one hand—especially the extent to which regional allotment is facilitated by natural or artificial circumstances—and the nature of the products on the other play a decisive part in determining the development of the various types. Thus apportionment of production quotas to the cartel members will depend upon the obvious condition that the commodities to be made the object of market control are more or less standardized and easily definable as to their qualities. The more inelastic the demand, the better are the prospects for cartels of the production quota type, which has found its largest application in industries producing goods of standardized mass production.

Cartelization of other products which do not meet these conditions must be performed—if it is at all feasible—by other ways of dividing the market. The definition of the market to be ruled by restrictive measures can be made on various lines. For example, in the whole market several markets may be dis-

tinguished and each made the object of differential production and price policy; and some of these markets may be left entirely to free competition on the part of the cartel members, while others are included in the agreement by way of a special bonus system. The varieties encountered in this respect in actual life are amazing, but the fundamental idea remains the same throughout.

Systems involving a more or less crude distribution of the market have very often resulted in widely unequal distributions of risks, thus promoting reactions on the part of the members who are prejudiced by the cartel policy. Continuation of common action may be strongly threatened under such circumstances. Thus efforts have to be made more or less constantly to devise specific methods providing for more adequate distribution of risks—though in practice even highly complicated and carefully balanced measures taken to this end have hardly ever met the purpose in a wholly satisfactory way.

It is evident that a considerable degree of monopolistic control over the market is the essential object to be arrived at. But the monopoly concept as commonly understood by economic theory takes here a specific aspect, owing to the fact that there does not exist, as is the case with the "normal" monopolist, a single economic unit controlling the market. Instead, there are a number of undertakings which are far from having uniform profit-making opportunities, and they are prepared, if it will better suit their interests, to recover their independence after the expiration of the agreement. Thus, apart from outside factors exerting restrictive influences on the monopolistic situation, the powers of collective monopolies are impaired by forces

operating from within. Price and production policies pursued by the "collective monopolist" will always be dependent on compromises aiming at the adjustment of divergent interests. Moreover, changes in the efficiency and the size of the allied undertakings will result in struggles over quota allotments and the methods of cartel policy to be chosen.

The actual means adopted for avoiding market risks by collective action are of course dependent upon the character of the market, the sentiments of the cartel members, and the views which prevail as to the character of control to be attempted. Naturally, methods designed to achieve greater control and more equalization of risks entail a correspondingly larger loss of independence on the part of cartel members.

The preceding considerations apply in the main also to "forced cartels" under which, by virtue of legal coercion, the cartel covers the entire industry and its policy is strictly controlled, if not directed, by the governmental authority. Whatever may be the reasons instrumental in enforcing cartelization on reluctant industries or at least in enforcing the obligation to join existing or proposed cartels on reluctant concerns, the establishment of some sort of collective monopoly is an essential feature of compulsory cartels as well as of their voluntary prototypes. Also, the principles of organization and general policy, though influenced by governmental supervision, are essentially the same with forced as with voluntary cartels. Compulsory cartelization, to be efficient, rests on the prevalence of the same economic conditions which are basic to the development of free cartels; and the methods relevant to securing control over the market are also alike.

Consequently there do not seem to exist sufficient

reasons for allotting to "forced cartels" a special place in a systematic classification based on the principles of division outlined above. This is especially true since coercion as a rule is applied only to industries in which strong cartels already have been established, thus securing their continuation as against disrupting forces; or to industries in which economic conditions would drive the majority of the concerns into cartelization were it not frustrated by the refusal of important competitors to co-operate.[10]

TYPES OF CARTELS

The possibilities for great diversity in the detailed forms of organization and methods of action have already been noted. A fairly accurate impression of the characteristic and centrally important activities of cartels can be secured by distinguishing a few dominant types.

Cartels Providing for Restriction of Output

Cartels of this simple kind have often developed from price-fixing associations when it has become evident that the efficacy of simple price agreements not backed by additional measures is threatened by any far-reaching changes of market conditions, particularly when such changes tend to increase the advantage of the larger and more efficient establishments. Thus, if any control over the market is really to be maintained, some means of protecting the position of the members in the market has to be provided for. This may be done in a rather simple way by obliging all members to close down a uniform percentage of their working machinery, or to reduce their working days or shifts at a uniform

[10] See Chap. VI for further discussion of forced cartels.

rate. In other cases uniform reduction of output, expressed in a certain percentage of the output of a given period, may be imposed on the member firms.

More refined methods are necessary when, in place of occasional and strictly temporary restrictions, more lasting regulation of production is to be substituted. Measures of this type are influenced by the idea of determining the purchasing capacity of the market for future periods, as compared with conditions of the past; of adapting the total output or the total sales of the cartel members to these figures; and of allotting each member a certain portion of the output, or a certain quota of sales, which the member is not allowed to exceed except under pain of penalty. The allotment of sales instead of production quotas permits the members to practice a somewhat more elastic business policy by accumulating inventories when the sales quotas are curtailed and delivering from stocks when they are increased.[11]

Calculations of the quantities or quotas allotted to the cartel members are commonly based on a rating of output capacity which is in most cases determined by an average based on production records over a period of years.[12] It is evident that each member will prefer the choice of such a range of years as will yield the highest possible quota for his plants. Considerable discrepancies of interest have to be overcome in settling such issues; and in many cases resort is taken to the expedient of determining the basic periods for each member according to his choice.

[11] See H. v. Beckerath, *Modern Industrial Organization*, p. 215.

[12] The various principles and methods adopted in determining the quotas to be assigned to cartel members have been made the object of careful investigation by German authors. See especially W. Hammesfahr, *Kartellbeteiligungsziffer*, Berlin, 1930.

Special difficulties arise with cartels including "pure" and "mixed" undertakings. "Pure" enterprises are those which produce entirely for the market; "mixed" are those which in part consume their own products in later stages of production. In determining a mixed concern's output capacity, it must be decided what allowance, if any, is to be made for those products which are consumed in the concern's own works. "Self-consumption" of this kind is, as a rule, exempt from the limitation of output and from penalties for excess deliveries, or at least subject to smaller restrictions or burdens than those generally established by cartel provisions.

Complicated schemes have been devised in order to overcome these and kindred intricate questions to the satisfaction of all concerned. But the difficulties involved tend to reappear, even on an enlarged scale, when an agreement is to be renewed, if during its period of operation important changes have taken place in the productive capacity of the member firms. To prevent such a development, which might threaten the very existence of the cartel, special restrictive measures are sometimes resorted to in periods of lasting depression, such as limitations upon the hours of work, upon the expansion of existing plants or the creation of new ones, and upon the introduction of improved machinery or new technical processes.

Cartel agreements confined exclusively to restricting output are rather rare. Unless some kind of price regulation is adopted resulting in automatic reductions of sales, the provisions relating to the restriction of output are not likely to be carefully observed. This is especially the case in periods of fluctuating business conditions, when the quantities of output which may closely cor-

respond to the conditions of the market are rather difficult to determine.

Therefore, as a rule, strict observation of minimum prices is made binding upon the partners to the agreement, since experience has proved the weakness of agreements regulating output without fixed prices. But here again, the interests of the cartel members may be widely divergent. Establishments operated at high costs per unit of output tend to insist on high prices while lower prices may better meet the need of concerns which feel themselves to be in a position to profit more from increasing their output and sales. Similarly, the interests of undertakings whose output consists exclusively of cartelized products are likely to differ from those of members who are also engaged in other lines of productive activity. Thus at any time when output and prices are to be adapted anew to changed conditions of the market, new compromises have to be made between the divergent interests unless one group among the cartel members is strong enough to force its demands on the others.

Cartels Providing for Adjustment of Sales Quotas

While under a system of restriction of production such as that just outlined, cartel members may be guaranteed a minimum price on a protected market, their business returns will nevertheless depend upon the respective shares of the total sales they may be in a position to secure for themselves. Whether or not the returns of a cartel member will be adequate rests with his competitive strength. When the elasticity of demand for the products of the industry is great, large divergences are likely to arise as to the distribution of

increasing or decreasing sales among the cartel members. Such a development tends to impair the harmony of interests upon which the cartel is established, and may make the very existence of the cartel precarious.

Therefore, the general idea of restricting output and sales came to be supplemented by the additional idea of securing each member a proportionate share of the sales effected. To serve this objective, arrangements are agreed upon providing for schemes of compensation. The proximate purpose is to secure for each member a share of the total sales returns proportionate to his rated productive capacity. The methods employed in many cases involve highly intricate administrative and commercial procedures. But the practical difficulties encountered are so great that, in spite of endeavours to establish satisfactory compensation schemes, it has hardly ever been possible to reach the ultimate goal, proportionate distribution of profits.

In principle, equalization can be effected directly by periodically transferring adequate portions of output and sales from members who have exceeded their quotas to those who have been in arrears; or compensation can take the indirect form of payments made to the members of the first group out of a fund resulting from contributions imposed on those who have exceeded their quotas.

Simple procedures for direct equalization through reallocation of quotas have to be greatly modified if the quality of the cartelized commodities varies widely from one period to another. Again, changes of prices obtaining during the compensation period must be allowed for; falling prices may annihilate the advantages resulting from supplementary quotas.

Indirect equalization of sales by way of monetary

compensation is the only expedient available in many finishing industries characterized by large differences in the quality and value of their products. Thus total sales of the cartelized firms are pooled and each is assigned a percentage correspondent to its quota. Excesses and arrears are to be compensated. To function effectively schemes of this kind depend upon detailed regulation of prices and cost accounting, due regard being taken for the various qualities of the commodities. Compensation is used as an indirect means for holding production in check and preventing price-cutting. It is hardly necessary to add that equalization of profits is not arrived at by agreements of this type. Very often it has proved necessary to provide for reserves accumulated in prosperous periods from general contributions in order to meet the claims of members suffering from insufficient sales during ensuing depressions.

It is evident that the various functions relevant to the operation of quota systems must be performed by some common agency charged with a far-reaching control over the cartel members' activities, as to the amount of their output, the sales effected, the prices obtained, and so on. Equalization of risks by schemes providing for adequate distribution of sales or equalization funds is still more dependent on the existence of a central office. In some cases its activity is so far extended that the cartel members are pledged to inform the office of all orders received or contracts concluded. Thus the institutional character of cartels, as contrasted with the mere individual obligations entered into by agreement, is largely enhanced by the creation of common agencies.

In Germany cartels of this type have rapidly developed in recent times in spite of the difficulties in-

volved in establishing adequate equalization schemes and in successfully adapting output and sales to incessant and far-reaching changes of market conditions.

Just for the sake of completeness, *cartels providing for an adjustment of profits* may be mentioned, though in recent times they have not played any noticeable role in industrial cartelization. They are on principle ruled by the idea of collecting in a common fund all net returns of the members, or in some cases merely the balance between the actual selling prices and basic prices agreed upon; and the amount thus accumulated is distributed among the cartel members according to their quotas, no regard being had for the sales effected.

Cartels Providing for Joint Sales Agencies: Syndicates

A good many of the difficulties involved in the attempts to arrive at a fair equalization of risks may be overcome by centralizing all sales in the protected market in the hands of a joint sales agency, commonly called a syndicate. It may be mentioned in passing that the term "syndicate" is frequently applied to denote the cartels which have adopted this structure, rather than merely to the sales agency itself. In Germany two separate legal acts are frequently performed in order to secure the smooth functioning of such institutions: one relating to the agreement entered into by the cartel members, the other instrumental in the creation of the sales office.

As a rule only industries producing highly standardized staple and bulk commodities lend themselves to the formation of cartels of this type, since the distribution of the orders received is to be effected by the central office. This office is excluded from any direct

oversight of the management of the affiliated undertakings. If standardization of the products is not sufficiently developed, efforts are required to repair this deficiency and eventually to differentiate the list of prices according to carefully elaborated standards of quality. Such an adjustment, however, can hardly be performed unless the number of the co-operating concerns is relatively small. Mining and heavy industries with highly concentrated forms of productive activity are the main industries in which syndicates have been established, as a rule by creating a special corporation to perform the syndicate functions.

Elimination of free competition among the cartel members, capable of being concealed by cartels of other types, is quite openly announced here. The central agency is not, as with other forms, merely authorized to direct the operations relevant to cartel purposes from behind the scenes; it is squarely faced with the market and charged with the task of effectively performing joint sales activities. The functions of the agency are not infrequently limited to the reception of orders and conclusion of sales contracts, leaving their execution and receipt of payments with the cartel members, who are often anxious not to give up direct relations with their customers. In this case special provisions have to be made in distributing output and sales according to the quota system agreed upon.

The strictest form of market control is possible only when the cartel members are deprived of any direct contact with the open market. In this circumstance the agency is charged with the performance of all commercial activities relating to the sales of the cartelized products, including the distribution of the orders among the members according to the prearranged scheme. All

transactions with purchasers are strictly centralized; and the cartel members, though preserving their individual risks as to the management of their establishments, lose any direct relations with their customers. Orders, if received by a firm, are transmitted to the central office and may be assigned for execution to other firms. Thus the cartel members are likely to be reduced to the role of productive agents working by order of the central syndicate, their interests being safeguarded as far as possible by elaborate schemes providing for adequate adjustment of their risks.

There are, apart from risk equalization, other potential advantages connected with joint-selling systems. Rigid internal organization is paralleled by the possibility of greater efficiency in handling the market with a view to adapting total output, sales, and prices to changing conditions. The "settlement" prices agreed upon between the syndicate and the cartel members are binding only for the intra-cartel accounting system while the members may get the benefit of a higher price which the syndicate eventually obtains on the market. A large scope is provided for applying a discriminatory price policy to various groups of purchasers.

Though on the surface ruled by the idea of strictly preserving the relative competitive situations existing among the cartel members, combinations of this type are very conducive to deep alterations of the structure of the industry concerned. They are likely to promote the creation of outright communities of risk established by mergers and consolidations. Quotas allotted to less efficient plants may be purchased by stronger members, with a view to closing them down, or a common cartel fund may even be created for the purpose of eliminating marginal producers whose high costs of production may

obstruct a policy of extending the market through a lowering of prices. Common funds may also serve the purpose of combating outside competition, of holding stocks, and of creating subsidiary plants or transportation facilities, and the like.

Concentration of sales in a powerful syndicate as a rule leads to important modifications of the relations obtaining between the industry and its customers. Wholesale dealers engaged in trading the products may be ruled out or reduced to the role of agents dependent upon the syndicate, as was the case in the coal-mining and the iron and steel industries in Germany. In Italy forced syndicates were charged with the task of providing credit schemes for financing the industry concerned. On the other hand, handling or using large quantities of the cartelized products may create "defensive" cartels in self-defense against attempts at monopolistic exploitation.

When syndicate policy forces upon purchasers deliveries made by such cartel members as the selling agency designates, as a rule a uniform freight basis is established. Freights for the deliveries from all works are charged from the cartel freight base instead of from the actual place of delivery.

By interfering with the customers' demands for materials of specified qualities produced by specific firms, the policy of strong syndicates unintentionally tends to promote vertical consolidation. This results in rendering important consumers independent of the market controlled by the syndicate, by bringing cartel members under their control. The development of the antagonism between "pure" and "mixed" enterprises within the German cartels, especially in the coal and the iron and steel industries, was largely due to this policy. In prosperity periods self-consumption by the integrated

(mixed) enterprises tends to increase and the syndicate's deliveries are thus impaired. In depression periods the same enterprises are less fully dependent on the open market, while the "pure" firms producing cartelized raw materials or semi-manufactured goods will experience the full reduction of their output as provided for by the restriction of total sales. "Pure" producers of finished goods are equally severely hit since they cannot avoid paying high cartel prices.

Regional Cartels

The second general method of dividing a market, that of division by geographical regions, is not strictly speaking an alternative to the first general method discussed in the preceding sections, that of prorating the aggregate volume of business. More accurately, or at least more commonly, agreements of the regional type are supplementary to those of the quota or syndicate types, for the purpose of making them more effective.

Regional agreements as such are not schemes for concerted restriction of output, but rest on the purpose of reserving definite markets to exclusive selling on the part of certain groups of producers. Other markets over which no sufficient control is possible may be left to face competition among the cartel members. Thus a distinction is made between "uncontested" and "contested" markets. Not infrequently the actions to be taken in the contested areas are equally ruled by common policy settled by the cartel. Since each uncontested market is controlled as a separate entity, there is no need for adopting a common price policy, and prices may differ according to the character of the demand in the several regional markets.

Agreement upon conventions by which certain re-

gions or areas are assigned for exclusive selling to certain groups of producers (*zone cartels*) is possible only under definite conditions by which the way is prepared for a considerable restriction of competition among the members in each zone. Such conditions result within national boundaries mainly from high transportation costs as compared with the value of the goods, or from similar circumstances limiting the shipping range of the commodities concerned, as is the case with coal, bricks, cement, and other bulky materials.

Market regulations of this kind are sometimes agreed upon between existing cartels which are thus combined into a "super-cartel." The conventions often provide not only a mutual guaranty of each cartel's uncontested market but also for a regulation of competition between the regional groups in disputed territories. Such is the case with the organization of the lignite, cement, and brick trades in Germany.

Assignment of regional markets for exclusive selling is the rule with international cartels organized for the purpose of reserving to each national group its home market. The idea of allowing regional spheres of business activity is often extended to markets lying outside the countries in which the cartel members are located. This way of restricting free competition on heavily disputed world markets is as a rule given preference to other methods (price- and quota-fixing and the like), since strict observation of the mutual obligations to be assumed in such cases is not easy of enforcement on international markets. Partners to such agreements are, as a rule, national cartels, but powerful corporate combinations may also be in a position to arrive at understandings of this kind with equal partners in other countries.

While the assignment of a territorial region to a single enterprise is rare, it is not unknown even within the boundaries of a given national market. There are, however, usually very special attendant circumstances, such as the existence of a single cement plant somewhat remote from competitors, to which is allocated all the business within assigned boundaries.[13]

Finishing Cartels

With the types of cartels so far discussed, restriction of competition applies to markets of more or less standardized products, the total amount of output or sales of which is made basic to the agreements. Such a market concept is not, however, applicable to industries with highly specialized products turned out by a relatively large number of concerns, as is the case for example with the German machine-building industry. Effective collective action in such industries requires not merely a production program covering all important lines in harmony with the supposed needs of the market, but also a considerable degree of standardization even of specialized types of products and some allotment of carefully selected groups of products to appropriate

[13] There exist a few instances of agreements setting up uncontested markets with assignment of customers to particular enterprises which do not properly come under the heading of regional cartels. They have aspects not greatly unlike certain aspects of the guild system, and exist almost exclusively in trades where long-term delivery contracts are combined with long-term credit arrangements. As an example the German brewery industry may be cited. Here the fundamental fact is the exclusive dealing contract between the brewery and its distributive outlets. The "cartel" is an agreement between brewers not to encroach upon, or attempt to secure for themselves, one another's exclusive outlets. Other somewhat rudimentary forms of allocation of customers are sometimes combined with other cartel methods with the object of safeguarding the relations existing between cartel members and their customers when the cartel is formed. Where the permanence of the cartel cannot be counted upon, this maintenance of direct trade relationships is a matter of importance.

groups of enterprises for exclusive production. In so far as the purposes are consummated, the demands of customers have to be modified in subordination to the interest of cartel members in the diffusion of simplified and standardized methods of production.

Combinations of this type, commonly but inadequately termed *finishing cartels* (or *standardizing cartels*) are characterized, as contrasted with other types, by some essential features. Restriction of competition is attempted not so much directly by regulating volume of production and prices, but by rationalizing production and sales. Prices charged may even be lower, owing to the advantages secured by serial production, than those obtaining under free competition as it existed before. Moreover, various devices and facilities placed by the cartel at the disposal of its members (common offices for projecting and drafting purposes, agreements concerning the interchange of patent rights, ample supply of informations as to technical improvements, and so on) may greatly assist the members in successfully striving against outsiders. It may thus happen that even a considerable amount of outside competition does not prove a real obstacle to the existence of the cartel.

In spite of these advantages, eagerly advanced by partisans of the rationalization movement,[14] a general reluctance to make the necessary adjustments has kept the number of such cartels relatively small. The reason for this reluctance is fairly obvious. The cessation of competition is attained, not merely by the usual cartel method of getting monopolistic control over the market, but by assigning to groups of members clearly delimited spheres of productive activity. On this account the

[14] For a definition of "rationalization," see p. 128.

degree of their dependence upon one another is greater than under any other type of cartel.

In order to carry out the common program the productive processes of each concern have to be adapted to the new lines set up by common consent, and this may involve more or less far-reaching reconstructions of the respective plants, and changes in the character of their products. Changes in the personnel and location of customers may also ensue. In both directions the economic consequences of this system may be so extensive that the way is barred to the re-establishment of the former conditions if for any reason the cartel should cease to exist. The individual member's risk may be increased by having its special limited range of products vulnerable to changes in market conditions, while shifting of production to more marketable goods is rendered difficult if not altogether impossible. For this reason, as a rule certain commodities of current consumption are not included in the program but may be produced by any cartel member.

For the special protection of the several differentiated producing groups, price-fixing, distribution of orders among the members, and even central selling agencies may be introduced where the degree of standardization is sufficient. Apart from the adjustment of risks accomplished by the distribution of orders, special funds for compensatory purposes may be created. Selling methods may be developed in a way to induce or even oblige the customers to purchase from cartel members commodities of different kinds produced by different cartel members, but complementary in nature (for instance different machines needed for the establishment of a plant). Outright monopolistic tendencies manifested in exclusive selling agreements, tying contracts, and other

methods may easily develop from a strong position of the cartel.

Cartels of this type were hailed by several German authors as promising starts toward developing forms of combination which are not anxious to get control over the market by the usual means of restricting output, but rather by increasing industrial efficiency, lowering costs, promoting standardization and rationalization, and efficiently organizing the relations between producers and the market. Special stress was laid upon the fact that price-fixing by finishing cartels may be ruled by a policy of promoting the adoption of improved methods of production and schemes of rationalization, unreserved compliance with the program being compulsory for any concerns affiliated with such a cartel. Some advocates of this new type—the adoption of which was recommended to finishing trades like textiles, shoes, household commodities, and so on—even went so far as to speak of a substantial change of the old cartel type brought about by this new feature. They raised the question whether the current definition of cartels must not be modified, since monopolistic control of the market is not to be considered as the objective of finishing cartels. It follows, however, from the market concept adopted by finishing cartels that here also restriction of competition is attempted, though by methods which are more commonly used by unified concerns than by combinations composed of establishments with distinctly separate risks.

Bidding Cartels

A still different market concept is basic to the creation of so-called bidding cartels, which in practice are of

varying nature. They are not concerned, like other cartel types, with the problem of how to protect the open market against outside competition and to adapt production to market conditions. They merely deal with proposed contracts issued by public authorities or large private concerns or institutions for supplying considerable quantities of specified commodities or for the erection of important construction works.

Since orders of this kind are commonly the occasion of violently competitive bidding, agreements are entered into by the competing firms with a view to distributing the orders among the cartel members. Thus the quasi-monopolistic situation of those inviting bids is neutralized by a procedure of fictitious bidding on the part of bidders which is usually secret. Partners to the agreement are bound to present their bids in a way which results in having the orders awarded in turn.

The arrangements made by the competing firms may extend from casual conventions to well-organized cartels headed by a central agency which is authorized to secure the efficacy of the scheme. Moreover, a special fund for compensatory purposes may be created out of the contribution of the members who exceed their share.

While the preceding sections of this chapter do not pretend to describe the many devices for making cartel policy effective, or to give a detailed account of the activities of cartels, they do, it is believed, make clear the general types of collective action to which the cartel concept may be wisely confined. Excluded from designation as cartels, on the one hand are those forms of agreement noted on page 25 which are almost wholly concerned with control over prices; and on the other

those forms of combination in which the individual business units lose their power of independent action through merger or intimate financial inter-relationship with other enterprises.

In order, however, to indicate the vagueness of the boundaries between cartels, strictly defined, and more intimate forms of combination, it should be mentioned that cartel-like organizations may be formed by other means than explicit voluntary agreements among entirely independent enterprises. They may in specific cases be brought about by indirect measures, especially by financial arrangements which give to a dominant concern or trust a high degree of control over the policy of competitive undertakings. The objective may be attained by interlocking directorates and similar measures suitable for co-ordinating the production and sales of competitive firms in compliance with a scheme established by mutual consent or forced upon the weaker members by the superior ones. It has become common usage to speak in such cases of "communities of interest." Since arrangements of this kind are, as a rule, obscured by the veil of secrecy, the degree of collective avoidance of risk established under these conditions is difficult to determine. The more the independence of some or even of all affiliated establishments is interfered with, the more combinations of this type are likely to be intermediate stages leading sooner or later to the formation of holding companies or of outright consolidations. The boundary line delimiting cases in which market risks are neutralized by collective agreement from those in which a new unit of risk-bearing is accomplished through financial combination, though quite clear for theoretical reasoning, is not always equally distinguishable in practice.

UNIFIED COMBINATIONS IN RELATION TO CARTELS

Combinations which involve the loss of financial independence lie entirely outside the cartel concept. Of this sort are the large combinations which have made up the substance of the American "trust movement,"[15] and which more recently have represented an outstanding trend of economic organization in Germany and England, and to a lesser degree in other countries. The pure prototypes of this movement are holding company groups and outright amalgamations, but these are of course supplemented by leasing arrangements and other devices for attaining centralized financial authority.

In the case of amalgamation an entirely new unit of risk-bearing obviously supplants the individual units which are combined, and any return to the previous state of competitive independence is almost wholly impracticable. In the case of holding companies the affiliated enterprises may, in external appearance, continue to give the impression of independent, even competing, establishments. But the appearance is illusory,

[15] The term "trust" is used loosely and ambiguously in the economic literatures of almost all countries, and for that reason will not be utilized in the present analysis. Deriving originally from a certain technical form of business combination, it has come to mean in more accurate and restricted usage any large combination with centralized financial control occupying a position of relatively strong monopolistic control. It has, however, on the one hand been extended frequently to cover all forms of monopolistic organization, including cartels and price-fixing associations; and on the other to cover very large financially unified combinations even though the monopolistic element is largely lacking. In Germany, where experience with cartels is most extensive, the term "trust" is uniformly used in a way to exclude cartels. It is, as a rule, used to denote powerful corporate groups in a single area of industry. Usually, but not uniformly, monopolistic tendencies are made a characteristic feature of "trusts." On the other hand the expression "Konzern" is very often used to designate large combines essentially based on financial interlocking without respect to whether the interlocked enterprises are in the same general area of productive activity. Thus, it has been common to speak of the "Stinnes-Konzern" and the "Thyssen-Konzern," to denote the interlocking interests of two outstanding industrial and financial leaders.

since the activities of all the companies are subject to a single profit-making purpose on the part of the controlling body; and the policy pursued by this body may result in thoroughly modifying the technical, administrative, and commercial organization of the combined concerns.

Large corporate combinations may or may not have monopolistic purposes. When of the horizontal type they do of course eliminate competition between the previously independent enterprises, but their monopolistic power may be relatively slight unless they include a very large fraction of the productive capacity, or use their influence to develop common policy among competitors with or without explicit collective agreements. Vertical combinations, joining enterprises in successive stages of production, have in themselves no monopolistic tendency, though in some actual instances they do of course occupy a relatively strong monopolistic position at one or more stages of production.

Two important points must be noted concerning the co-existence of cartels and large unified combinations. The first is that when a relatively large corporate combination is formed in any field of cartel activity, the character of the situation may be changed by the existence of a dominant cartel member. The cartel may have less of the character of a voluntary partnership and more that of an imposed co-operation. The second is that combinations of the vertical type may cut across several fields of cartelization. While becoming a member of all of them, the combination is at the same time a part of the market for some of them, and the divergence of interests between such "mixed" enterprises and "pure" enterprises respectively may largely influence cartel policy.

When organized solely for purposes of increasing productive efficiency and divorced from intent to control the market, unified combinations have little in common with the typical purposes of cartels. When organized for monopolistic control of the market the purpose is to that extent similar. But, as already mentioned, the economic circumstances which are most favorable to the emergence of such combinations differ rather strikingly from those most conducive to the forming of cartels. In the course of changes in the organization of various industries, cartels have very naturally represented a development which facilitated a later movement toward unified forms of combination. Nevertheless, it would be very misleading to suppose on this account that the two may be lumped together as merely two different expressions of monopolistic tendencies. This point will be developed in the following chapter.

CHAPTER III

ASPECTS OF CARTEL POLICY

The term "cartel policy" as used in this connection covers the measures and means adopted by cartels in order to secure the realization of the objectives pursued by common action.[1] The vast field of this policy can adequately be divided into two large sections: one dealing with internal policy, that is to say, with the relations existing between the cartel and its members; the second with external policy, that is to say, with measures involving direct interference with the markets of the cartelized products. It is evident that the borderline between these two sectors cannot always strictly be drawn. Apart from the following sub-section on price policy, some of the important aspects, especially of internal cartel policy, are discussed in the preceding chapter dealing with the classification of cartel types and in a later chapter dealing with the economic effects of cartelization. Hence the present chapter is intended to cover a limited range of striking features of cartel policy.

GENERAL LINES OF POLICY

The general lines of cartel policy are dictated by the object of maintaining the existence and furthering the profit-making interests of all concerns combined for this common purpose. This objective is pursued through control of the market, which means essentially control of prices and control of market supply. The two phases

[1] Common usage is ambiguous in that it sometimes applies the expression "cartel policy" to the policy of the state towards cartels. Throughout the present writing the term is not used in this sense.

of control are perhaps to be considered the opposite sides of the same coin. If any priority of importance is to be assigned it should perhaps go to price control, to which all other methods of promoting the interest of the allied enterprises may be considered more or less subordinate, including even the case of finishing cartels.

There is, however, deeply inherent in the nature of the cartel movement the tendency to stabilize the distribution of productive capacity among the members as it exists at the time the combination is formed. If finishing cartels are left aside, pursuance of cartel policy does not on principle imply far-reaching obligations on the part of the cartel members to adapt their business management, the technical equipment, and the productive processes of their plants to the conditions of the market in such ways as they would unquestionably be forced to do under the rule of free competition.

If cartels were ever capable of drawing the ultimate theoretical consequences of the general idea underlying their creation and functioning, they would be ruled by a policy of controlling the expansion of productive capacity in close correspondence to the trend of the curve of demand for the industry's products, fluctuations of demand due to merely cyclical changes being entirely left out of account. It is evident that this ideal postulate is impossible of being adopted in practice and it has, as a matter of fact, hardly ever been seriously envisioned.

In any case, increases of the productive capacity of the industry, though they may indirectly result from cartel policy, are not due to deliberate common action but to the increased endeavor on the part of individual concerns—cartel members or outsiders—to derive the greatest possible advantages from this policy by adapt-

ing to existent or prospective demand the organization and the size of their plants. They remain in the sphere of individual initiative, and not of collective action.

Thus cartel policy as such is, apart from some minor exceptions, not concerned with the expansion of outlets, the increase of productive efficiency, the lowering of costs of production—in a word with problems in the sphere of ever renewed initiative. On the contrary, the initial concern of cartel policy is how, in a limited market, to control the use of industrial over-capacity which is considered to be a lasting or recurrent evil, incapable of being abolished, but capable of being mitigated in its effects on the cartel members. This restrictive cartel policy has at times gone so far as to prevent cartel members from expanding their establishments or embarking on lines of production reserved for other concerns. Such was the case with the German Raw Steel and Ingot Cartel when it was reorganized in 1924.

The tendency to restrict output capacity is, as a rule, even more manifest in the objectives pursued in the creation of forced cartels. The obligation to comply with restrictive schemes is forced upon reluctant concerns which might prefer to retain their freedom of action. Arguments in favor of enforced cartelization are, as a rule, derived from the reasoning that there exists in certain industries a lasting "over-capacity" which can be adequately reduced by concerted action.

POLICY REGARDING OUTSIDERS

Control over a market which is too small to absorb the total available output at profitable prices means reservation of the market for exclusive selling on the part of the cartel members, thus enabling the cartel to adopt distributive devices. Consequently any concerns

not affiliated with the cartel and absorbing a portion of the market's purchasing power present a danger to the use of such devices. This danger varies with the degree of the competitive strength of outsiders, and with the degree to which they may be favored by the cartel's price policy. From the angle of "cartel consciousness," outsiders are to be considered as enemies of the common cause of the industry. Thus, broadly speaking, the existence of the cartel becomes safer and its effectiveness greater as the portion of the total productive capacity of the industry which it can control increases, and as the prospect of strong outside competition declines. Industries in which the creation of new, or the expansion of existing, enterprises is dependent on large capital investments are well fitted for the activity of strong and lasting cartels whenever a large majority (perhaps 70 per cent) of the productive capacity is represented by the undertakings allied for common action.

The threat of outsiders endangers the cartel in periods both of expanding and contracting markets. It is, however, more serious in the latter case. The outsider is in a better position to adapt prices and selling terms to the conditions of the market than the cartel members, restrained in their freedom of action by the obligations imposed upon them by common policy. Thus an outsider may derive advantage from the reduction of output forced upon the cartel members and operate his plants to a high degree of their productive capacity, being indirectly protected against heavy price-cutting by the cartel's price policy. It is easy to understand that high cartel prices are difficult to maintain when customers are in a position to play off the terms offered by outsiders against those established by the

cartel; and infringements of the agreement on the part of the cartel members are in this case likely to ensue.

Thus struggle against outsiders is an essential protective object of cartel policy. Some measures adopted with this end in view are not exclusively employed by cartels, but may be equally used by strong unified combinations for the sake of forcing down dangerous competitors. But the specific features they take, if resorted to for cartel purposes, are worth mentioning. They may be divided into three main groups:[2] (1) measures of price policy; (2) measures taken with a view to blocking important sources of supply; and (3) measures taken for the purpose of hitting the outsider's outlet.

(1) There is no need to deal at any length with the methods of sharp price-cutting applied for the purpose of fighting against outside competition. They are very well known from the history of the trust development but, of course, less easily handled if the execution of this policy is left to individual cartel members who are to be compensated for their losses out of a common fund. If, however, all sales are strictly centralized in a common agency, a more flexible price policy can be adopted, and discrimination of prices may be effected, even over long periods, between markets in which competition is active and those in which the cartel's monopoly is firmly established.

(2) Far more characteristic of the specific nature of cartels are the methods employed with a view to impairing the outsider's activity by cutting off the supply of important elements of production, especially raw materials and semi-manufactured products, and even labor and credit. The more cartels are composed of

[2] For the study of the problems involved here, see especially S. Tschierschky, *Kartellpolitik*, 1930, to which the present author is greatly indebted.

members who, owing to the development of vertical consolidation, themselves control the output of important raw materials—as is the case with the German heavy industries—the more the way is open for an application of this method. This may go so far in extreme cases that no concern staying outside the cartel can find a seller of the materials needed.

The same objective may be attained by agreements concluded between cartels controlling successive stages of production, to the effect of securing exclusive selling and buying between the cartels concerned. In this case the members (or the joint sales agency) of the cartel controlling an earlier stage of production are pledged to sell only to members of the other cartel, and commonly, the members of the latter are obliged to purchase the materials exclusively from the members of the former, or its agency. Thus, by boycotting methods the monopolistic power of both combinations may be rendered almost unassailable. In the German iron and steel industry a lasting interlocking of this kind was established by the creation in 1925 of a common head-cartel, the Steel Works Federation, for the purpose of coordinating the policy of a score of sub-cartels operating under its general leadership.

Cutting off the supply of labor is a method especially employed in Great Britain by way of the so-called "alliances," that is, agreements entered into between employers' and workers' organizations with a view to securing for cartel members the exclusive right of employing organized hands, in return for assurances of wage increases corresponding to price increases secured by cartel policy. A specific modification of the closed-shop principle is adopted here for the purpose of preventing outsiders from getting qualified men for their

plants. But conditions conducive to such conventions are likely to obtain only under exceptional circumstances. In Germany similar agreements were concluded in pre-war times. They lost in importance after the war when collective bargaining and, eventually, compulsory extension of the terms of labor contracts over whole industries were made essential elements of labor legislation. Since, under the régime ruling in the Third Reich, trade unions of any type have been completely dissolved, this method is there no longer of any account.

Cutting off the supply of credit may be used as an effective weapon against outsiders by strong cartels closely connected with the leading banks of the country. In a country like Germany, with highly developed cartel systems, banks are as a rule decidedly in favor of this policy, since it is likely to provide a safer basis for industrial credits than a condition of violent competition which might threaten the solvency of important debtors. This is the more true when, as in Germany, banks do not confine their credits to short-term loans, but typically make long-term capital commitments in the industrial enterprises of the country.

The position of the cartel may be strengthened against outside competition by legal monopolies based on patent rights, either by agreements concluded between the cartel members and providing for the interchange of patent rights, or in exceptional cases by purchases of important patents by the cartel itself for exclusive exploitation on the part of the members. These expedients have been increasingly resorted to in recent times.

From among the many cases of unique, and often radical, methods of preventing the existence of outsiders or crippling their operations, an illustration may be

taken from the cement industry which has, in Germany, Switzerland, and elsewhere, been the seat of violent struggles between cartels and outsiders. A cement cartel in Northern Germany in 1928 entered into an agreement with a group of farmers by which the latter were pledged not to sell any ground suitable for the erection of cement plants for a period of 20 years.[3] There of course exist in different industries all sorts of special circumstances which human ingenuity can take advantage of for similar purposes.

(3) Direct measures taken with a view to hitting the outsiders' outlets are implied in the above-mentioned agreements between cartels for securing exclusive mutual trade, since outsiders' products are then boycotted by all members of the other cartel partner to the convention. In other cases in which the customers are not knit together in a way which permits making them directly serve the purpose of the cartel, more indirect methods of getting their support have to be resorted to. They may be applied to industrial consumers or dealers, as the case may be.

Special discounts of unusual amount may be granted to customers for commodities purchased from cartel members or a selling agency if the customer complies with a tying contract, according to which he is bound to cover his demand for the cartelized goods exclusively from such members or agency. Many such contracts are concluded in a rather loose form for an indefinite period which may be terminated by the customer's decision to renounce the privilege of extraordinary rebates and to recover his freedom of buying whenever he chooses. Strong cartels are, however, accustomed to requiring the inclusion in sales contracts of a tying

[3] See Wagenführ, *Kartelle in Deutschland*, 1931, p. 170.

clause with a definite duration, commonly one year. Additional stipulations may be added in trading with wholesale dealers, such as requiring them to force upon their customers a similar tying clause. Or in dealing with industrial customers, the latter may be required not to produce the cartelized commodities on their own account. The right is explicitly reserved to reclaim the total amount of the rebates granted if the contract is not strictly kept.

It is evident that tying contracts with individual customers are dependent for their effectiveness upon the specific conditions of the market. Their continuation, or even strict observance, may be seriously impaired in periods of falling prices when, owing to the price policy pursued by a cartel, the advantage resulting for the customer from the discount granted may be largely offset by the more favorable terms offered by outsiders.

The monopolistic effects of tying contracts can hardly be compared with those of exclusive trading agreements between organizations of sellers and buyers. In Germany, especially after the war, in certain lines of trades exclusive trading developed between producers' cartels and wholesale dealers' organizations, which in some cases were even created at the request of the cartels and made subservient to their policy.

A more striking method of securing complete control over the market is outright elimination of wholesale trade. Strong syndicates were the first to adopt this policy, but many cartels in the finishing trades were also successful in creating selling agencies of their own to perform wholesale functions. It may be mentioned that judgments on the commercial efficiency of cartel agencies as compared with that of professional merchants are not entirely favorable. The business policy

of syndicate executives, who are dependent on instructions from the cartel and hold positions secured by long-term contracts, is reported to degenerate easily into bureaucratic routine work such as is often characteristic of government administration.[4]

EXPORT POLICY OF CARTELS

The cartel concept of a limited market to be divided equitably among its members may be brought into clearer relief by examining cartel policy with respect to the expansion of markets. Endeavors directed, not towards distributing among cartel members the sales available on the limited market, but towards effecting an expansion of outlets, are not as such typical of the cartels. Initiative in this respect is left to the individual concerns; and even strongly organized cartels, when they have adopted the system of central selling, are often anxious strictly to limit the system to the market protected or possible of being protected against outside competition. Prices and other selling terms relating to business activity in unprotected areas are regulated by the cartels only so far as to maintain and support the price and production policy on the controlled market. This is largely true of cases in which the home market is divided into a contested and an uncontested area. It applies even more to cartels which have succeeded in monopolizing the entire home market against competition from abroad, and are faced with the question of how to deal with their members' export activity.

Dr. S. Tschierschky, whose broad and intimate knowledge of cartel problems is based on many years of practical experience, clearly points out the rudimentary export policy of cartels. Having stressed the

[4] See H. v. Beckerath, *Modern Industrial Organization*, p. 247.

importance of exports of cartelized products, he shows that there have existed in Germany very few industrial cartels of the higher types which were equal to the task of promoting exportation.[5] Sales of cartelized products abroad have been looked upon, from the cartel's point of view, as a means of removing the pressure of productive capacity from the home market, and have thus been regarded as particularly important in connection with industries especially marked by degressive costs. If the prices fixed for the protected market can be saddled with a large part of the burden of fixed costs, export at prices covering little more than the direct expenses involved in producing the exported commodities will prove profitable. Thus discrimination of prices between uncontested domestic and contested foreign markets—that is to say, selling at lower prices abroad than on the home market—is a method of cartel policy resulting from the very nature of the cartel's monopolistic situation.

Even "dumping" in the narrower sense of the term—that is, selling abroad at discriminatory prices which are below the average cost per unit of output—may be practicable and profitable for lengthy periods if the importance of degressive costs is so great that the low export prices are outweighed by the reduction of cost per unit of output due to the increased volume. The decision will rest, in this case, with the margin of profit obtainable on the home market and the relation of the exported quantities to the total volume of output.

Though under such circumstances cartel policy is highly instrumental in furthering sales abroad, direct promotion of exports, as already stated, usually lies outside this policy, and competitive action on external

[5] Tschierschky, *Kartellpolitik*, p. 98.

markets is left entirely to the initiative of the individual concerns. Exceptions to this rule may be found only in cases in which a syndicate is charged with the full task of handling the cartel's selling policy or in which the attempt is being made to extend monopolistic control to what has been a contested market. As an example of how haphazard the export policy even of strongly organized cartels may be, a few years ago the joint sales agency of a cartel found itself engaged in competition with powerful cartel members on foreign markets.

Price-cutting on foreign markets may be facilitated by special features of cartel policy. Thus, as a rule, exported quantities are not taken into account in levying contributions to the cartel treasury. In other cases direct subsidies are granted proportionate to the exported quantities. Whether all cartel members are asked to contribute to the funds needed for financing such systems, or only those directly participating in the export trade, depends, however, upon how the collective risk involved is defined. This issue, resulting from divergence of interests of cartel members, may even threaten the cartel's existence. It played an important role in the history of the Rhenish-Westphalian coal cartel. In 1925, when the cartel was about to be renewed under government pressure after prolonged negotiations, a solution was arrived at to the effect that only those mines which sold abroad through the cartel should share the expenses of competing with coal of different origin.

The general idea basic to any cartel policy directed towards securing closed markets strongly protected against outside competition, is of course particularly reflected in international cartel agreements providing for a clear-cut delimitation of uncontested areas, and

even for appropriate restrictions of total productions and sales, equalization of profits resulting from sales in contested areas, and so on. With the development of international cartelization, the cartel idea received world-wide application. But international cartelization, as such, does not tend to promote export trade; it rather tends to restrict it.

A further policy of cartels which has an important relation to exports is that of granting to their customers bonuses for exports of products made from materials or semi-manufactured commodities purchased from the cartel (for example the giving by an iron or steel cartel to machine manufacturers of a bonus for sales abroad). However it would be misleading to include such arrangements under export policy strictly speaking. Stimulating sales in the home market is in such cases the essential object in view.

High prices of cartelized products which constitute important elements of costs in later stages of production may easily be shifted to the ultimate consumers when the home market is protected at all stages of processing by adequate duties against outside competition. On markets abroad, however, shifting of heavy cost elements is less practicable, particularly where these markets are themselves protected by tariff barriers. Exportation of finished commodities, and, consequently, sales of the cartelized materials on the home markets, may be seriously impaired unless the manufacturers producing commodities for export purposes are granted bonuses to offset the high prices for materials ruling on the home market.

Iron and steel products are the principal goods which in Germany, Austria, France, and Czechoslovakia have been made the object of such arrangements, concluded

as a rule, between cartels. It has not infrequently happened that in this connection cartelization has been forced upon manufacturing trades by cartels existing in the basic industries. This development was promoted by the fact that cartel-fixed prices for the products of later stages of production tended to simplify the problem of administering the price policy of the cartelized basic industries. As a rule, special accounting offices were created with a view to controlling reimbursements on account of materials going into exported goods.

After the war the so-called Avi-Agreement concluded between the Raw Steel and Ingot Cartel and the Federation of the German Iron Consuming Trades (*Arbeitsgemeinschaft der Eisen verarbeitenden Industrie*), for the purpose of granting export bonuses to the latter trades, became an important factor in influencing international competitive conditions, especially of the German concerns engaged in machine construction. Similar arrangements were made with regard to other cartelized semi-manufactured products (brass, rolled wire, and the like) which are largely used in manufacturing export goods. These post-war arrangements may be distinguished from their pre-war patterns in that granting of the bonuses is no longer made dependent upon the cartelization of the consuming concerns.

It goes without saying that the idea underlying the creation of American export associations created by virtue of the Webb-Pomerene Act has very little in common with the export policy of cartels. These associations—and similar ones in other countries—are supposed to be established with a view to securing new foreign outlets for the products of the allied concerns. Consequently their creation and activity may be favored by world-wide prosperous business conditions rather

than by contracting markets and shrinking purchasing power. The idea of protecting prices and sales in the home market does not enter on principle into their primary considerations. In practice, however, it has sometimes been forced upon them as an afterthought derived from their contact with international cartelization schemes aiming at a partition of uncontested markets.

PRICE POLICY OF CARTELS

The real touchstone enabling the observer to arrive at an adequate understanding of the exact nature of cartels is the price policy they pursue on the controlled markets. Price policy is bound to be governed by the general tendency underlying any cartel policy directed towards mitigating the individual risks of cartel members and towards stabilizing their mutual competitive relationships. There may in practice be many degrees of realization of the latter objective, and in any case it is evidently quite impossible for "stability" to materialize fully under the existing evolutionary conditions of markets, technical progress, capital supply, and management. But it nevertheless provides cartel policy with a "rational principle" which, in doubtful cases, takes precedence over other considerations.

Stabilization of competitive conditions involves, above all, preservation of the existence of all members of the cartel. This cannot be effected unless prices are adapted to the costs of production of those members who are producing under the least favorable conditions. Costs of production of marginal producers, thus defined, will almost always be higher than prices resulting from free competition; but cartel prices need not always cover such costs, since weaker members may be indemnified by various methods of refined cartel policy

such as creation of compensation funds. In any case, however, the costs of high-cost producers constitute a focal point in the making and administering of cartel price policy.

The costs of production of all cartel members are likely to be increased by various measures taken for safeguarding the monopolistic position of the cartel, such as underbidding of outsiders, purchase of competitive undertakings, acquisition of patent rights, and development of new sources of the cartelized raw material. An important cost element is also involved in the maintenance of a joint sales agency. In some degree, however, such costs may be offset by savings which the members are able to make by not having to incur selling or other expenses.

It is inherent in the very nature of cartels that the divergencies of interests existing between their members are impossible of ever being completely eliminated. The development of cartelization tells the story of repeated clashes between the demands of rather conservative concerns producing at relatively high costs and less interested in increased sales than in high prices, and other partners to the agreement moved by opposite interests or views of market strategy.

In order to arrive at a theoretically correct estimate of the advantages secured by cartelization, each cartel member would, at any given period, have to compare the profits which might be derived under a system of free competition with those resulting from cartel regulation of production and prices. Under free competition prices might be lower but the volume of sales larger. Restriction of production imposed upon the cartel members not only reduces the number of units by which profit per unit of output is to be multiplied, but it is

also instrumental in increasing costs of production per unit of output by reason of the rule of degressive costs. These two elements are the essential constituents of what may be termed charges consequent upon monopolization. If prices fixed by the cartel do not permit the individual concern to cover these charges, the creation or continuation of the cartel is not in harmony with its interest.

Strikingly different elements may govern the calculation of different enterprises. Thus a concern rather poor in mechanical equipment but employing many hands may be in a position, by heavy payroll deductions, to prevent a reduction of volume from increasing its unit costs appreciably. It may therefore prefer a policy of restricted production and relatively high prices. On the other hand, a competitive concern loaded with large capital costs may be less interested in curtailing its payroll than in exploiting fully the expensive mechanical equipment which becomes a dead burden if left idle. Reduced output even at high prices may be detrimental to it.

It is thus easy to understand why the existing cartels are threatened not only by the prospect of rapidly expanding markets, promoting the full display of competitive forces by large and efficient concerns, but also by heavy and prolonged depressions. If, with a view to preserving the existence of marginal producers, total output or sales of the cartelized industry are curtailed by a high percentage, the increasing burden of fixed costs may become unbearable to those very members who went furthest in replacing labor by expensive machinery.

This problem, intricate as it may be of itself, may be complicated by the absence of uniform cost accounting

methods among cartel members—a very common situation. The application of different principles of cost accounting, and in particular different systems of charging off depreciation and obsolescence, may so affect the calculations of individual members as to make agreement upon collective price policy problematical, especially in industries in which technical progress plays a considerable role and technical equipment undergoes rapid obsolescence.

Under such circumstances assessment of quotas is likely to become the object of serious conflicts between members with highly rationalized plants and other more conservative members whose existence might be threatened by low quotas combined with a lowering of prices.[6]

Under the more highly organized types of cartelization relatively adequate devices have been contrived to cope with the difficulties, such as those noted, inherent in the nature of collective monopoly. This is especially the case in industries where the tendencies toward rationalization and corporate concentration are strong. It has been common for quotas assigned to weaker members to be purchased by large concerns, placing the latter in a position to increase their output accordingly and to influence price policy in the direction of moderate prices designed to secure larger volume. Quota purchase may serve as a prelude to corporate combinations or to the purchase of inefficient plants for the purpose of closing them down. The process of concentrating quotas in the hands of relatively few large concerns has advanced during recent times, especially

[6] Since divergencies of this kind are sometimes especially accentuated between concerns of different countries, international cartel agreements are particularly exposed to the danger of falling apart in periods of heavy depressions.

in the German potash, coal, steel, and cement industries, in some lines of the iron manufacturing industries, in the printing paper industry, and elsewhere. The costs involved in such transactions are to be reckoned against the advantages realized by exploiting to a fuller extent than heretofore the plants owned by the purchasers.

There exist in each industry, however, definite limits to the continuation of this process. On closer examination it is seen to be rather opposed to the general tendency of cartels directed towards maintaining a competitive *status quo* among the cartel members. As concentration of production progresses, the existing divergencies of interest tend to increase, especially between small or medium size members and powerful large members. Instances are not lacking in which cartels have even resorted to the expedient of preventing their members from purchasing quotas allotted to others or from merging with them.

In any case, production and price policy of cartels in periods of depressed business conditions is rather easy to understand. It is essentially determined by the tendency to shift to purchasers the risk involved in falling prices by maintaining price levels profitable even for the "marginal" producers and thus to provide some sort of insurance against the risks involved in free competition.[7]

[7] Without unduly stressing the analogy, the collective methods used for avoiding competitive risks permit a parallel to be drawn with the general background of insurance schemes. In both cases individual risk is to be modified by the establishment of some sort of collective risk-bearing. Again in both cases, owing to the importance of the risk problems involved, appropriate measures are to be taken with the ultimate object in view of reducing and somewhat equalizing the risks of the participants by common action. As a matter of fact, compensation funds established by cartels bear a striking resemblance to crude and simple insurance schemes and this resemblance is the more accentuated the more some sort of profit pooling is arrived at.

In many cases the easiest method is to maintain the existing price level when business conditions turn from prosperity to depression. This policy may be supported by the consideration that lowering prices during the early stages of the depression period may have little power to bring increases of effective demand. Later on, as the depression takes its prolonged course, gradual reduction of prices may become imperative; but the bottom reached by cartelized prices will almost always be considerably higher than that which would be attained by free prices.

Since the price policy of cartels in depression periods is limited by the necessity of safeguarding the existence of the marginal producer, it is bound to be supported by restriction of production proportionately for all combined concerns, irrespective of the efficiency of their plants. This objective has no parallel in the calculations of a unified monopoly. And it negatives the selective function of prices under free competition.

In appraising the monopolistic power of cartels it is not to be overlooked that various circumstances operate to check exaggerated price demands, quite apart from the moderating influence exercised by public opinion. Above all, constant heed must usually be paid to existing or potential outside competition; and even cartels which are safely in control of domestic production are limited by foreign competition unless transportation charges, customs duties, international cartel agree-

By way of contrast, however, the ordinary insurance scheme does not have to overcome conflicts of interest among the participants, while strong antagonisms resulting from competitive relationships have to be overcome under a cartel scheme. Again insured risks are those capable of more or less accurate actuarial computation. And finally, insurance is almost wholly a matter of reducing risks by pooling them, while collective monopolies are designed to shift a part of their risks to other groups of the economic community.

ments, or other barriers are prohibitive. Thus a general fall of prices on the world market will force down cartel prices in the absence of such prohibitive barriers.

It is not equally easy to explain the price policy generally adopted, at least in post-war times, by the most important cartels in periods of expanding trade and rising prices. Cartels, especially those controlling markets of raw materials and semi-manufactured goods, have shown themselves rather tardy in following the general upward swing of prices. They tend to cling to the prices fixed under depressed conditions. Even later on, when rising costs of production on the one hand and urgent demand for cartelized products on the other lead to price increases, the level of cartel prices typically rises by a smaller percentage than that of unregulated prices.[8]

Thus diagrams showing the trend of cartelized prices are likely to be composed of series of straight lines, each of which extends over a lengthy period. The average level of these lines is, in depression periods, higher than the level presented by the general average of uncontrolled prices, while in prosperity periods the respective position of the lines is the opposite. By calculations based on the method of standard deviations it has been shown for Germany that during the period from 1926 to 1931 fluctuations of cartelized prices amounted

[8] The question to what extent the general validity of this statement can be upheld has been the object of repeated discussions. As far as pre-war cartels are concerned, the policy of the Rhenish-Westphalian Coal Syndicate was certainly marked by the tendency to stabilize prices in prosperity periods. Though the same tendency was quite generally said to be characteristic of other cartels of the basic industries (especially of the iron and steel cartels), it was shown by careful examination that "bound" prices fluctuated hardly less than free ones. Studies of prices under post-war cartels, however, give evidence of a strong tendency toward stabilization. There continues to be some dispute on this point. Contrary views are surveyed by A. Wolfers, *Das Kartellproblem in Lichte der deutschen Kartelliteratur*, 1931, p. 62.

to about one-fifth of those observed for free prices.[9]

The explanation of this behavior of cartelized prices cannot be found in any simple rational principles of economic behavior; and it is of interest to note that the reasons given usually imply psychological or even sociological considerations rather than clear-cut lines of economic analysis. Thus in a survey made by Dr. Wolfers the following reasons for the failure of cartel prices to follow upward swings rapidly and fully were advanced: (1) the far-sighted policy of cartel managers in entrenching the position of the cartel by keeping prices up in the preceding period of low prices; (2) the fear of public criticism aroused by high cartel prices; (3) the cumbersome price-fixing machinery, especially of big cartels, which renders price changes rather difficult and may explain the tendency towards delaying their adoption; and (4) the effort of powerful cartels to impose their dictatorial will on the market, and in so doing to disregard changing market conditions.[10]

Such considerations are also no doubt supplemented somewhat by the mistaken idea that efforts to stabilize prices may be instrumental in stabilizing general economic conditions, or at least the market of the industry concerned.[11] Fear of fostering outside competition may also be instrumental in making for a moderate price policy, but considerations of this kind are the less important the stronger is the monopolistic position of the cartel.[12]

[9] H. Wagenführ, *Konjunktur und Kartelle*, 1932, p. 28.

[10] Wolfers, *Das Kartellproblem*, p. 63.

[11] See p. 105.

[12] In connection with the points made, the following observation by Professor J. Schumpeter has some relevance: "We have much less reason to expect that monopolists will charge an equilibrium price than we have in the case of perfect competition; for competing producers *must* charge it as a rule under penalty of economic death, whilst monopolists, although having a

The slowness of cartelized prices to advance may perhaps in part be explained by the fact that production is, during the depression, more restricted in cartelized trades than in those marked by free competition. Owing to the principle of degressive costs, mere increase of the volume of production may result in what are considered satisfactory profits through reduction of unit costs. The incentive to exploit a monopolistic position is thereby weakened. There is not sufficient evidence to say whether or not this range of motives operates much more strongly in cartelized industries than elsewhere.

Whatever the character of the motives which in specific cases promote a policy of moderate price increases in prosperous periods, its adoption by even strong cartels no doubt in some degree reflects the circumstances of their origin. Starting as they commonly do with the initial purpose of escaping competitive risks of weak markets, their leaders are rather uneasy in adapting their policy to the changes resulting from expansion of markets and rising prices. Their motives run less to full exploitation of monopolistic power than to escaping the risks of competition and insuring the continuance of the cartel. The purposes are probably wisely served by looking cautiously forward to coming market declines during which heavier reductions would be necessary if larger increases were made in the present; though on the other hand, relatively low prices charged in periods of brisk markets are likely to stimulate the tendency towards over-expanding the industry's productive capacity.[13]

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motive to charge the monopolistic equilibrium price, are not forced to do so, but may be prevented from doing so by other motives." "The Instability of Capitalism," *The Economic Journal*, 1928, Vol. 38, p. 371.

[13] See p. 123.

Price policy of cartels, irrespective of special conditions of the market, is marked by the tendency inherent in any monopolistic price determination to charge discriminatory prices. Discrimination may merely involve different prices for customers in the protected and contested markets respectively. Or it may involve "skimming" the protected market in accordance with the paying capacity or disposition of customers, on the principle of "what the traffic will bear." Discriminations of this kind are of course kept in the dark as far as possible, taking such concealed forms as freight rebates and special discounts or bonuses; and their influence on the level of "bound" prices is therefore impossible of being taken into account by statistical researches.[14]

In conclusion, however, it needs to be said that a good deal of confusion and uncertainty exists in cartel circles concerning the adjustment of prices to varying circumstances of the market. The actual methods, except in the best organized cartels, are rather haphazard, and there cannot be said to be any well-developed rational theory of cartel price policy.

CARTEL POLICY AS CONTRASTED WITH THE POLICY OF UNIFIED COMBINATIONS

The price policy pursued by cartels is brought into sharp relief if compared with the corresponding behavior of unified combinations. Just as cartels are ruled by the influence of the conditions to which they owe their existence, so unified combinations establishing new units of risk out of formerly independent undertakings are subject to special influences which cause

[14] Wagenführ, *Konjunktur und Kartelle*, p. 27; I. Dobretsberger, "Kartelle unter dem Drucke der Krise," *Archiv für Sozialwissenschaft*, Vol. 68, Pt. I, p. 44.

their policies to be deeply contrasted with the conservative tendencies of cartels.

Cartels are organizations based on common consent of the partners to the agreement which is concluded for a limited period, a far-reaching independence of the allied concerns being strictly preserved. A large degree of equality of rights of the members is requisite for safeguarding their individual interests. In so far as coercion is imposed on the members by the cartel, the compulsory power is based on the agreement by which the mutual obligations are settled with a view of serving common purposes.[15]

In contrast, following consolidation or "trustification," the unified combinations have a single profit-making purpose, even though this unity of purpose may be obscured by maintaining the appearance of independence among the combined enterprises. There is no need for adopting a policy adapted to the diverse interests of a considerable number of undertakings. Flexible measures may be adopted; cost-saving technical devices and methods of rationalization and scientific management may be applied over the whole range of establishments controlled by the central board responsible for the financial management.[16] If it is thought desirable, production may be concentrated in

[15] In the case of compulsory cartels, regulatory provisions are quite generally based on agreements entered into by the majority of the members of the industry; and the decisions of the majority are imposed by state interference on the dissenting minority.

[16] The role played by the principle of reductions of cost in the policy of unified concerns—as contrasted with the cartel policy of adapting prices to given costs—has been especially emphasized by Italian authors who were largely influenced by Pantaleoni's theory. (See F. Vito, *Sindacati Industriali*, Milan, 1932, pp. 15, 113.) Recently several German authors have strongly insisted upon the fundamental difference existing between cartels and unified combinations as to the relation to be established between prices and costs. See Wolfers, *Das Kartellproblem*, p. 13.

the best-equipped plants; and specialization of production by plants, based on a comprehensive program, may be put into effect to the highest possible degree. Sales may be centralized and orders distributed over the affiliated establishments without any idea of equalizing their returns.

Unless highly monopolistic in character, a unified combination must make cost reduction a primary consideration. And whether monopolistic or not, cost reduction will always be a sound purpose of business management. In this matter, indeed, no distinction need be made between individual business units, however large or small. Profit-wise, reduction of costs is always good business policy.

For comparison in the present connection, those unified combinations so large as to exercise a considerable degree of monopolistic power are the most relevant. The most striking contrasts are: (1) that being mainly the creatures of prosperity, their policies are not dominated by a "depression psychology," as are those of cartels; (2) that they are in a position, if it comports with their interest, to adopt highly flexible price and production policies in adaptation to changing market conditions; and (3) that they operate under a continuous incentive to make improved methods of production a primary pursuit.

On the other hand, it is true that, as with cartels, the pressure of depressed market conditions is likely to sharpen the endeavors of unified combinations to strengthen a monopolistic position, since self-protection against the risks of a weak market is a sharper goad than opportunity to exploit a favorable one. The measures adopted for this purpose are likely to be akin to those employed by cartels in the struggle against

outsiders. But the existence of well-organized unified combinations is by no means seriously threatened—as is the case with cartels—if they fail to reach the monopolistic objective. And their production and price policy, if backed by some sort of monopolistic power over the market, is hardly ever likely to be dominated by the restrictive and conservative features characteristic of cartel policy.

Too sharp a contrast between the policies of collective monopolies (cartels) and unified monopolies should not be attempted, since the instances in which the latter at all fully and effectively escape the hazards of competition are relatively rare, and are likely to depend upon the acquisition of control over patents or limited raw materials, or some other essential and restricted element insuring the continuance of a privileged position. In the face of depressed market conditions, very large concerns are therefore commonly subject to the same kinds of competitive risk as others, and for that reason commonly associate themselves with the cartel movement. As a matter of fact, in various European countries this movement owes some of its most characteristic features to the development of strong unified combinations, especially in the heavy industries.

Nevertheless, since corporate combination and cartelization are in some degree alternative roads to the end of monopolistic control of the markets, it is important to be aware of their characteristic differences. The concept of the market basic to the policy of large combinations ruled by unified profit-making purposes does not essentially differ from that characteristic of any other single enterprise which is embedded in the meshes of the capitalist economy. In a realm of free or even of relatively limited competition, a universal equilibrium

concept embracing the economic system as a whole is fundamental to the activity of every enterprise, no matter whether even a single business man has ever grasped its true significance.[17] Its application results from the constant pressure brought to bear upon competing concerns to reduce their costs of production and consequently their prices, with a view to increasing their output and sales.

On the other hand, the efficient action of collective combinations is conditional upon measures which are based on a partial equilibrium concept which regards a market as a well-defined entity on which only a limited volume of output can be sold at profitable prices. A specific partial equilibrium concept is bound to be adopted by any organized group of competing concerns, as contrasted with the universal concept which governs the action of single competitive concerns. The creation and maintenance of collective monopolies amount to incessant endeavors to establish partial equilibria whose features are determined by the profit-making interests of organized groups, while no heed is taken of the conditions under which the equilibrium of the whole system can be established or maintained.

Hence the type of "planning" introduced into the capitalist economy by cartels cannot, with rare exceptions, be based on far-reaching foresight of future developments, which enter but little into the motivation of cartels. As a rule, they are ill fitted for devising and adopting measures with a view to a more distant future, but are rather ruled by the needs of the day. "Planning" of the kind characteristic of large unified concerns is

[17] See the author's article, "Controlled Competition and the Organization of American Industry," *The Quarterly Journal of Economics*, May 1935, Vol. 44.

quite different in nature, since they are ruled by a centralized profit-making purpose to which other considerations are to be subordinated; and the focus of policy is centered on a program of efficient production and expanding productive activity.

If the whole range of differences existing between cartels and unified combinations is clearly borne in mind, the influence exerted on the trend of industrial development by general conditions of the market, and especially by cyclical business fluctuations, is shown to be a matter of prime importance. Rapidly expanding markets will promote unified combination; tightness of markets, particularly if accompanied by prolonged depressions, will prepare the ground for cartelization. In the longer trend of the combination movement, however, the two are closely related, in that the looser cartel forms of combination create new situations and relationships in which the closer forms of combination may subsequently flower.

This much is shown by the history of the capitalist system, that sooner or later unlimited free competition of independent concerns has, in all industrialized countries, been at least partly superseded by the creation of powerful combinations resulting in far-reaching modifications of industrial risk-bearing and competitive conditions. The extent to which, in particular countries, the combination movement or the cartel movement or both have developed is to be explained only in terms of a complex of conditioning circumstances, but cannot be fully explained without reference to the character of business fluctuations and prospects as they have differed from country to country. Differences of legislative or administrative policy may affect the relative strength of the two movements, just as they may hold

the scales somewhat between competitive organization and all forms of the monopolistic tendency. But these very policies themselves in considerable degree originate in the underlying economic circumstances which determine the relative strength of the various tendencies. Legislative measures for checking the development either of cartels or of strong unified combinations are confronted with the most serious obstacles where the prevailing trends of the market provide strong motivation toward one or the other.

CHAPTER IV

VARYING INTERPRETATIONS OF THE CARTEL MOVEMENT

The role played by cartels in modifying and remoulding the system of capitalist economy, and the effects of cartels on the various classes of producers, workers, and consumers, have been and are still the object of heated controversies, which are not always free from considerations of personal or group interests. Quite apart from clearly self-interested views, which can be disregarded in the present analysis, there is no doubt that deep-rooted divergencies of opinion may arise from fundamental differences of approach in interpreting the processes of the present economic system. In particular, the role played by free competition and the mechanism of prices in the process of producing and distributing wealth is a disputed subject.

Advocates of the system of competitive capitalist economy are inclined strongly to condemn any attempts towards monopolistic control over markets. It is argued that, whenever the distribution of the national dividend is modified to the advantage of those exerting the control, not only does the amount to be distributed decline but also the working of the mechanism of prices is disturbed in a way which impairs the re-establishment of the economic equilibrium and accentuates the forces operating towards upsetting economic equilibrium. From this point of view cartels are regarded as highly prejudicial to the smooth functioning of the capitalist system.[1]

[1] A fuller discussion of these points will be found in Chap. V.

There are, on the other hand, quite apart from radical socialistic adversaries of the present economic order, those students who are inclined to regard unhampered free competition as responsible for heavy losses which they believe are incurred through the incessant elimination of valuable economic assets consequent upon the competitive struggle for markets and the misdirection of capital investments. Failure to develop the lines of industry producing capital goods in harmony with those creating consumption goods is laid at the door of unrestricted free competition; and attempts toward adapting the production of capital goods to the lasting purchasing power of markets are welcomed as promising starts towards introducing some sort of planning into the "anarchic" state of production. Viewed from this angle, cartels are said to replace blind and reckless competition by a system of mutual understanding, tending towards developing output capacity of the industries in concert with the real needs of the market. Control over the market is conceived as an indispensable corollary to the task of barring over-investment, over-production, and disproportionate developments of basic lines of production. Views of this sort may cover wide variations of opinion concerning desirable degrees of modification of the capitalist system, and at their extreme point may come into close contact with the more moderate socialist point of view.

CHANGING POINTS OF VIEW

Before the World War, belief in the overwhelming advantages presented by the system of free competition—at least on the home market—was almost unshattered in all European countries westward from the Rhine as well as in America. Central European countries, es-

pecially Germany and Austria, were the territories where, side by side with the development of cartels, the arguments for cartels took characteristic form. In Germany, especially, cartels were tolerated and at times officially favored and protected. There was little public opinion against cartels as such, and they were quite generally believed to accomplish some favorable stabilizing effect. Active criticisms centered upon the specific ways in which cartels used their powers, and the issues of public policy were concerned with the types and degrees of public control to be exercised, rather than with the right of cartels to exist.[2] No strong body of opinion promulgated the precepts of economic liberalism.

The general economic argument for cartels was developed by economists whose intellectual roots grew from the historical school of economic thought, which was on principle opposed to the system of free competition. In conformity with their general liking for strong interference by the state in economic life, adherents of this school advocated official supervision of cartel activities. Attempts were made to assign cartels a definite place in a system of economic policy meant to control and direct economic forces in ways conducive to national prosperity and to competitive superiority in world markets.

The historical school suffered, however, from serious limitations upon its methods of analysis. It was prepared to dismiss, along with the system of free competition, the belief in the equilibrium concept, which is basic to insight into the functioning of the price mechanism. It neglected the analysis of economic phenomena in terms of rational motives, logical sequences, or

[2] See p. 120 n.

trends derived from market data. It was thus lacking in almost all the scientific tools appropriate for searching analysis into the nature and the economic effects of cartels. Vague guesses as to these effects, largely influenced by a general liking for a more collectivistic organization of the economic system, took the place of careful economic analysis.

Cartels were paralleled with trade unions, co-operative societies, and even large corporate or other unified combinations, as elements in the evolution of the competitive capitalist system into a different one, based on autonomous collective action instead of competitive struggle. Since this line of thought subscribed to the ideal that, on principle, co-operative action represents a higher type of organization than individualistic procedure, the conclusion was near at hand that cartelization represents an advance from the system of free competition.[3] But the arguments advanced in favor of this view were hardly at all derived from a consistent body of economic thought.

Such views on the merits of cartels were not actively controverted by economists of liberal persuasion, who for the most part paid little attention to the cartel movement. In Austria, where a liberal school of economists flourished, attention was mainly centered upon the development of systematic economic theory, and economists concerned themselves but little with the analysis of new institutional developments. The socialists of course entertained a special philosophy of their own which need not be gone into here, but which, being sympathetic to collectivistic developments, could foresee in collective monopolies some drift in the direction of their ideal. Of popular opinions in all their varied

[3] See A. Wolfers, *Das Kartellproblem*, p. 8.

forms it can be said that there existed no strongly organized body of opinion opposed to cartelization as such.

After the war, when cartelization sprang up afresh and rapidly spread not only over Germany but also over other highly industrialized European countries, discussion of cartel problems revived on a much larger scale than ever before, and aroused increasing and lasting public interest. It is a striking fact that public opinion, which had in pre-war times in many countries been hostile to the exploitation of monopolistic power by cartels, now became almost all over Europe rather unanimous in acknowledging cartels as unavoidable, or even necessary, outcomes of modern economic development. They came to be regarded as essential factors of national and international economic policy. Thus, as against pre-war times, the main issue was profoundly altered. Also, discussion in other than Central European countries no longer turned on the question whether cartels were to be suppressed or prohibited, but rather on the measures to be adopted by legislation and administration for preventing abuses of monopolistic power.

This trend of public opinion is clearly reflected in the resolutions with regard to "international industrial agreements" passed by the 1927 World Economic Conference. The Conference recognized "that the phenomenon of such agreements, arising from economic necessities, does not constitute a matter upon which any conclusion of principle need be reached, but a development which has to be recognized and which, from its practical point of view, must be considered as good or bad according to the spirit which rules the constitution and the operation of the agreements, and in particular

according to the measure in which those directing them are actuated by a sense of the general interest."[4] The same attitude is taken by the overwhelming majority of European economic writers engaged in the study of cartel problems, however divergent may be their individual views and their general line of approach.

The reasons for this veering round of opinion, especially in Western Europe, may be found partly in the fact that far-reaching changes of economic organization, developing with what seems irresistible force from imperative needs of those concerned, are bound to be accepted as irrevocable events impossible of being abolished by state interference. But it would be misleading to interpret this attitude as a purely tolerant one. It is backed, in many countries, by the conviction that strong cartels—as well as large and powerful unified combinations—are in a far better position to defend national economic interests on the world markets and to promote national economic supremacy than are isolated concerns which rely exclusively on their own forces in the struggle of international competition. Cartelization, having initially been a purely national problem and therefore largely ignored in countries where it did not flourish early, has turned out to be a matter of great international importance.

To these considerations a third reason may be added which, though rather vaguely felt and hardly ever clearly expressed, should not be entirely overlooked. It is more economic in nature than those so far advanced. Pre-war economic theory and practice, as developed under the influence of the liberal or individualistic line of thought, tacitly accepted a concep-

[4] *The International Economic Conference, Final Report,* Ser. L.o. N. P., 1927, 46(a), p. 43.

tion of economic life which rather assumed a continuous expansion of production, and an equally continuous rise of the general standard of living. Set-backs taking the forms of crisis and depression were commonly attributed to outside non-economic causes, such as disturbing political and natural events. Where such causes were evidently lacking, market recessions were laid at the door of misdirection of capital investments due to errors of business judgment; or to unexpected changes of consumption habits; or to technical improvements involving displacement of many hands and disproportionate developments of important lines of industry.

But any such extraordinary maladjustments were considered, by this way of reasoning, to be irregular and more or less accidental events likely to be overcome very soon by the automatic working of economic forces governed by the mechanism of prices and constantly operating towards restoring equilibrium. Consequently any attempts to replace the self-healing tendencies of unrestrained competition by "artificial" measures such as restriction of production, price-fixing, and the like were held prejudicial to general economic welfare, since they were believed to impair the functioning of the price mechanism.[5]

The general acceptability of this view collapsed among the economic upheavals which followed in the backwash of the war. As one of its after-effects, over-

[5] A striking example of this line of reasoning is presented by the cartel theory as advanced by Pantaleoni (*Alcuni osservazioni sui sindacati* reprinted in *Erotemi di Economia*, Bari, 1925, Vol. II). Any combinations tending towards monopolistic regulation of production and prices—in contrast to those aiming at a reduction of costs—are regarded as passing phenomena and antiquated forms of industrial organizations. From the angle of the rigid equilibrium concept basic to his theorizing, "regulated competition" meant an open contradiction, an absurdity. See F. Vito, *I Sindacati Industriali*, Milan, 1932, pp. 95 ff., 122.

capacity of productive equipment became, in many European countries, a characteristic and seemingly lasting feature for important lines of basic industries (coal, iron and steel, textiles, and eventually chemicals and shipbuilding). The situation was complicated by, and in some degree caused by, new national boundaries and trade barriers. On one side of a border old plants would be cut off from a part of their market, while on the other side new plants were being built to supply it. Serious doubt arose whether, within the calculable future market expansion might be expected to be sufficiently great to absorb the product of the steadily increasing capacity to produce. The relatively high degree of unemployment obtaining in several European countries even during prosperity periods seemed to lend strong support to this doubt; and in some quarters pessimistic criticism even went so far as to express the fear that the capitalist system, in Europe at least, had lost the faculty of adapting productive capacity to the purchasing power of markets. With faith shattered in the continuity of market expansion and in the salutary effects of competition, measures of combined action providing safeguards against the consequences of ruinous competition were considered conducive to an improved economic order.

Thus economic considerations combined with strong nationalistic tendencies to modify public opinion with regard to the effects of cartelization on the development of national wealth.

CURRENT APPROACHES

The character of the current controversies can only be understood, in so far as they are conflicts of informed economic observers rather than of self-interested

parties, by examining the preconceptions which color various approaches. These preconceptions are on the whole of a political sort, in the sense that they represent personal preferences concerning schemes of economic relationships. In so far as they are not of that character, they represent certain intellectual views concerning the evolutionary drift of economic institutions, and conceive the problems of public policy to be essentially those of adjusting action in detail to the requirements of the trend. Unfortunately these political and evolutionary preconceptions tend to color even careful analytical researches into the nature of cartels and the economic effects of their activities. Several lines of approach to the study of cartel problems can be distinguished.

(1) Persons who are convinced that competitive capitalism secures the best means of organizing the economic system deplore the extension of private monopoly. Of the general attitude of this group no more need be added to what has been said at an earlier place (page 92). One point, however, may well be noted. Since the existing facts of economic organization do not permit a competitive régime to be envisaged in all fields of enterprise, a strong tendency exists among members of this group to approve a clear division of industries into two categories: one consisting of industries in which competition can be effectively maintained; the other including industries strongly monopolistic in tendency, in which monopoly organization should be accompanied by severe regulation or public ownership.

(2) Another group of observers, finding merit in the cartel system, consider that the capitalist system is not seriously modified by the spreading of cartelization. They minimize the monopolistic character of cartels,

but argue that unhampered free competition is not an indispensable characteristic of the present economic order. In this view, cartelization does not amount to abolishing competition, but to keeping it under appropriate control by the elimination of ruinous cut-throat competition involving heavy and useless losses of productive investments. The application of the concept of "planned" or "regulated" economy to the markets controlled by cartels is said to be mistaken, since private initiative in determining the course of productive processes is not touched by cartelization.[6]

(3) A third group, largely carrying on and elaborating certain views of members of the historical school, insist on the conception of the cartel movement as an important factor in remoulding the present capitalist order by introducing into it elements of "regulated economy," as contrasted with unregulated competition. They envisage the maintenance of the system of private enterprise, modified by greater elements of collective action and public regulation. Although it is unnecessary to go into all the diverse views concerning the institutional changes to be made, one variant of this general viewpoint is worthy of special notice. A distinction is made between structural and cyclical changes experienced by an economy in the course of its development. So far as cartels and other combinations are made lasting and integral parts of the economic system, they are considered to be important elements of structural change, thus modifying the very process of cyclical

[6] Arguments of this type are sometimes so far stressed as to result in largely modifying the current monopoly concept. If the principle underlying free competition is supposed to secure the constant relation between costs and prices, a monopoly established by a cartel is said to be far more in harmony with this principle than free competition conducive to prolonged disturbances of this relation.

fluctuations. This evolutionary recasting of the present economic system is held to be consistent with the principles underlying profit-making capitalism.

The general line of approach need not vary greatly between this group and the one mentioned immediately before it, since both are looking primarily at the evolution of institutions within the confines of the capitalist system. They essentially differ only in their interpretation of the importance of the phenomena under discussion in relation to the modification of the economic system.

In principle the same attitude is adopted by the partisans of the Italian Fascist theory. This theory is centered on the idea of the *Stato totale*, under which the Fascist state is conceived as the moral, political, and economic unit of the nation. Thus national economy, made subservient to the nation's struggle for power, is considered an integral whole, to be directed in accordance with the collective needs of the state. This does not necessarily mean abolition of free competition. On the contrary, in various connections, and especially in the Italian *Carta del Lavoro* (that is, the law regulating the relations between employers and employees), private initiative has been declared the most efficient instrument for promoting the objects of national economy. But, in so far as cartels and other combinations designed to restrict or supersede free competition are considered conducive to the promotion of national economy, they are to be supported by measures of general economic policy, which is in principle favorable to industrial concentration as contrasted with isolated action on the part of many small concerns.[7] Thus Italian economists of the Fascist persuasion, though

[7] See Vito, *I Sindacati Industriali*, p. 297.

far from subscribing unreservedly to the principles of a planned or regulated economic system, are inclined to emphasize the advantages attributed to cartelization, especially in industries working under degressive costs and threatened by the danger of cut-throat competition.[8]

(4) Clearly distinct from the reasoning of economists so far discussed is the line of approach adopted by many socialist authors. Their interest is focussed on the question whether or not the steady progress of cartelization is to be considered an essential factor in transforming the capitalist system, which according to socialist tenets harbors and is doomed by inherently antagonistic tendencies. This particular way of presenting the problem is closely connected with the growing liking, on the part of many socialists, for dismissing the Marxist idea of socialization brought about by a revolutionary process; and for replacing it by the concept of "evolutionary" socialization. Roughly speaking, this means slow but steady remoulding of the capitalist system, by forces working from within, into some sort of planned economy largely rid of private profit-making. Along with the development of other institutions of a collectivistic type—trade unionism, municipalization of public utility services, increased expansion of public works, and so on—cartelization is reckoned among the elements for building up a new economic system which might be termed "organized capitalism,"[9] marked by

[8] Some further discussion of the similar viewpoint of the National-Socialist régime in Germany will be found on p. 184.

[9] There exist, in scientific and popular discussion, many other expressions used to denote the same idea but tinged, respectively, with specific shades of political creed. Such expressions are: economic democracy, planned economy, co-operative economy, riskless economy, state capitalism, financial capitalism, state socialism, social liberalism, and so on. See J. Dobretsberger, *Freie oder gebundene Wirtschaft*, 1932, p. 7.

increasing degrees of control exerted by the state and its organs over vast provinces of industrial activity. Sooner or later, it is argued, the state will be obliged to assume authority in supervising and directing the policy of strong monopolistic combinations. "Organized capitalism," being transitional in nature, will be conducive to a final stage to be reached when cartels will be transformed into public autonomous bodies under regulations for promoting the common weal. Though the validity of this prognostication has been questioned by the partisans of the orthodox socialist creed, belief in some sort of evolutionary socialism has been instrumental in influencing the attitude adopted towards cartelization by leaders of trade unionism of socialist shade.

THE ECONOMIC ARGUMENT FOR CARTELIZATION

The economic case for cartelization usually starts from a consideration of the economic wastes involved in free competition. Competition as it actually operates in the present highly developed stage of capitalism does not, it is argued, result in a rationally organized economic process guaranteeing the maximum volume of production. The system, it is contended, is marked by misdirected and ill-timed investment, an inordinate rate of obsolescence of equipment, excessive fluctuations of business conditions, and irrational destruction of capital values. It is assumed that new modes of collective action are required to correct these defects of the system, and that cartels are a useful experiment in the right direction.

In contrast with unrestrictedly competitive industries, it is argued that cartels attempt to adjust the increase in productive capacity to a long-range trend rather than in response to a transitory rise in demand.

Co-operation facilitates the accumulation of reserves in times of business prosperity and prevents their rapid extinction through cut-throat competition in periods of depression.[10]

In this connection the cause of the stabilizing effects of cartel policy is pleaded by the reasoning that price-fixing in depression periods permits employers to be satisfied with smaller profits in periods of expanding markets. The maintenance of a relatively stable price level is said to be of great importance also to those producers who depend upon the cartelized products for the manufacturing of their goods and to the dealers in the finished commodities. The risk involved for manufacturing concerns in frequent price fluctuations is said to be largely reduced by price-fixing, since the necessity of speculative accumulation of stocks to cover them against rising prices of materials is removed.

Other arguments point to the fact that in periods of falling prices purchasers stay out of the market as long as the view prevails that prices will keep on falling, which exaggerates the downward trend. This attitude may be counteracted by maintaining the level of cartelized prices. On the other hand, exaggerated purchases made upon anticipation of rising prices will be avoided if prices are kept constant; sudden and abnormal expansions of the market will thus be prevented. Raw materials cartels are credited with special merits in these respects.

Summing up such considerations advanced by many authors, Professor K. Wiedenfeld, in a report submitted to the World Economic Conference of 1927, arrives at the following conclusion:

The steady movement of coal and iron prices must from

[10] See B. Burn, *Codes, Cartels and National Planning*, 1934, p. 155.

the economic point of view be interpreted in connection with the fixing of railway tariffs and the systematic adjustment of the bank rate. Just as every country has for a long time been at pains to remove the rate of interest and transport costs from the arbitrary conditions of the open market into the sphere of the controllable . . . so, too, as regards the prices of the most important raw materials, a steady systematic movement is preferable, from the point of view of general economic interests, to the chaos of the world market.[11]

Stabilizing effects of cartel policy are, by another line of argument, initially traced to their fundamental tendency to safeguard the existence of all the allied concerns. Concentration of huge fixed capital investments in industrial undertakings is said to have impaired the functioning of the price mechanism. Output may easily be adapted to the demand resulting from expanding markets; but, when prices are falling, efforts to lower costs of production are obstructed by the rigidity of capital costs and of other cost elements, often including wages. Moreover, the effort to reduce costs by adopting the most efficient methods of production may often cause additional capital to be invested, though market conditions are such as to call for both a curtailment of production and an interruption of capital investment. The implicit idea involved in this argument is that business enterprises are entitled to protection from the risk of having to sell below cost in weak markets; and sometimes this idea is explicitly stated, on the ground that the emergence of profits from business operations is essential to the operation of the capitalistic system. To have force, the argument must assume that depressed markets represent the "normal" state of business.

[11] K. Wiedenfeld, *Cartels and Combines*, Ser. L.o. N. P., 1926, II, 70, p. 26.

Pursuing the idea that competitive prices are likely to be below-cost prices, advocates of cartelization object to any judgment that cartel prices are improper because they are higher than might obtain under free competition. It is contended that competitive prices are likely to be improperly low. More or less contradictory is the defense of cartel prices on the ground that in the long run even strong cartels will not be able to raise the price much above the theoretical competitive prices in view of the limits set to the exploitation of their monopolistic situation (fear of outside competition, expansion forces working within the cartel, opposition of organized consumers and of counter-cartels, and the like).[12]

As a matter of fact, almost all unbiased observers agree that few well-organized cartels follow the aggressive policy of establishing the highest possible prices which would be required if the principle inspiring their policy were the extortion of the highest possible profits. Strong emphasis is laid on the fact that such a policy, commonly called the "children's disease" of cartelization, has proved to be detrimental to the existence of many cartels and has given way to the tendency towards stabilization of prices.

In recent discussions of cartel problems some cartel advocates have vigorously questioned the advantage to the economic community of the unhampered introduction of technical improvements and cost-saving methods which are relentlessly forced upon enterprises under a system of free competition. Slow and temperate remoulding of productive processes is thought of as preferable to precipitate development involving technological unemployment, rapid obsolescence, and other

[12] H. v. Beckerath, *Modern Industrial Organization*, 1933, p. 264.

wasteful accompaniments. Cartels are credited with the merit of modifying the effects of selective evolution with generally beneficial results. Less efficient plants incapable of holding their own under free competition may be rescued from immediate ruin and slowly absorbed by stronger cartel members. Thus, it is argued, cumulative closing down of many establishments may be avoided and dismissal of the hands employed by them delayed and distributed over lengthy periods. As against this view, however, when cartels have been criticized because of an alleged tendency to retard the introduction of technical improvements and scientific management, many cartel advocates have strongly denied any such tendency.

The apparently contradictory viewpoints are not wholly so. Thus the contention may be merely that, while cartels do interfere somewhat with the competitive process, they do not in any effective way bar the way to reasonably rapid advance in technological improvement. Thus, in a special report published by the cartel agency of the Central Federation of German Industry, an attempt was made to show that in a number of industries (iron manufacturing, printing, paper trade, incandescent mantle trade, plate-glass trade, velvet manufacturing and so on) cartels were successful in increasing industrial efficiency by closing down poorly equipped plants.[13]

Closing-down operations may naturally be variously interpreted. Critics may call them merely steps in the development of monopolistic control, while defenders praise them as advancing the efficiency of the industry. It is of course not at all impossible that both ends should be accomplished in one and the same operation. A strik-

[13] See H. Müllensiefen, *Kartelle als Produktionsforderer*, 1926, and *Schriften der Kartellstelle des Reichsverbandes der Industrie*, No. 5, 1929.

ing instance is that of the renewal of the cartel convention of the German Steel Ingot Federation in 1929, when a closing-down program was agreed upon, providing for a reduction of output capacity by more than one million tons of pig iron and steel ingots, the costs of this operation being figured at from 80 to 90 million marks.[14] In Great Britain efficient schemes designed to reduce the surplus productive capacity of the industry have been adopted in shipbuilding (in 1930) and flour milling (in 1929). In both cases funds have been secured from a levy on the industry for the purpose of financing the retirement of the redundant firms.[15]

Closing-down operations are of two kinds, those adopted by the cartel as a matter of policy and those carried on by separate members by the purchase of quotas, or actual absorption of other members' plants. The two sides of the cartel defense may somewhat follow this distinction. Operations of the first sort are cited to show that the cartels as such follow a policy which eliminates high-cost producers. Operations of the second sort are cited to show that, even though other cartel members may bitterly resent them, the individual incentives to improvement march steadily on.

Various types of cost reduction are put down to the credit of strongly organized cartels, especially such as are equipped with efficient central agencies. These include eliminating competitive advertising; organizing deliveries on regional principles; reducing the risk in-

[14] This operation was based on the assumption that free competition was likely to be re-established unless the total capacity of the industry was forever reduced by the volume mentioned above. In this case a fall of prices by 10 per cent was expected to occur which would have brought about a decrease by about 250 million marks in the total returns of the industry. Therefore it seemed more profitable to all members of the agreement to pay, out of a common fund, the costs of closing down an adequate number of plants.

[15] See A. F. Lucas, "British Movement for Industrial Reconstruction," *Quarterly Journal of Economics*, February 1935, p. 214.

volved in granting doubtful credits to consumers; centralizing sales and eliminating intermediate profits made by wholesale dealers;[16] and, last but not least, promoting standardization of output. The system of introducing trade-marks current for all cartelized products of a certain type regardless of the origin of their production is said to be a particularly strong incentive for increasing the controlling functions exerted by the central cartel agency. Standardization and rationalization rank first among the tasks of the so-called finishing cartels.

Specific arguments are advanced to justify so-called "defensive" cartels in industries in the later stages of production composed of relatively small enterprises, with a view to protecting them against monopolistic powers exerted over the markets of raw materials and semi-manufactured goods, and against the superior economic situation of large corporate combinations, wholesale dealers, chain stores, co-operative societies, and the like. Such special arguments are beside the point in connection with a discussion of the general merits of cartelization. They have, however, this special significance, that much of the advocacy of extending cartelization comes from persons who are not in the least enthusiastic about cartels as such. But, taking the existence of cartels in the raw materials and heavy industries to be inevitable, they are concerned to prevent other parts of the economic structure from being oppressed. Having little hope of the general restoration of conditions of free competition, they propose to

[16] The tendency of cartels to reduce wholesale dealers to the role of agents dependent upon the dictatorial power of the producers has been made the object of prolonged discussions in German economic literature. There is a remarkable lack of agreement as to the effects on the economic structure resulting from the conditions of wholesale trading under a system of cartelization. See Wolfers, *Das Kartellproblem*, p. 89.

neutralize monopolistic power at one point by creating it at others.

Optimistic observers of the cartel movement are inclined to look into the future and to forecast profound alterations of the attitudes of business managers in response to the wide development of cartelization, especially if international in nature. As MacGregor has it:

> It is possible that the growth in the scale of control and of responsibility, as well as the increased security against intermittent competitive raids, will lessen the purely profit-making motives with which these national concerns are conducted, and enhance the conception of public service. There are examples which go to show that a sufficiently wide sphere ot industrial responsibility is often now regarded as at least as attractive as high political office to men of the first order of ability, whose motive is rather the doing of big things than the making of greatest profits. If it is desirable that the government of an industry should be regarded as a service comparable with the administration of a public department, then it is desirable that the scope of industrial control should be such as to call for the highest application of energy and service, and it is a tenable position that national control plus international agreements represent the form which will both require and create the most patriotic view of management.[17]

Most cartel advocates do not rely upon such expectations, which are felt to be improbable of materializing unless accompanied by other far-reaching changes of general economic policy which are not yet in the range of sight. Eminent experts on German cartel problems such as Tschierschky believe it would be utopian to expect cartels, in the calculable future, to be guided by other than the profit-making purposes of their members.[18]

[17] D. H. MacGregor, "International Cartels," Ser. L. o. N. P., 1927, II, 16, p. 6.
[18] S. Tschierschky, *Kartellpolitik*, p. 10.

CHAPTER V

ECONOMIC EFFECTS OF CARTELIZATION

Though interesting and important in their own way, analyses of the cartel movement either in terms of political preferences or as interpretations of the institutional evolution of capitalism, do not greatly illuminate the economic effects of cartels in relation to a given economic environment. Again, descriptive analysis of existing cartels and discussion of their merits proceeding on the lines of institutionalist approach is as a rule limited to the examination of such effects as are traceable to cartel activities within a narrow range of economic events occurring under specific, singular conditions which hardly permit broader generalizations to be drawn. If, however, an insight into the general effects of cartelization is to be arrived at, some sort of more abstract reasoning has to be adopted.

Efforts of the latter sort are becoming more numerous on the part of economists, who are endeavoring to examine the effects of cartel activities upon the operative processes of producing and distributing wealth by methods of rigorous economic analysis. Work of this kind has been assisted by the rapidly growing volume of descriptive inquiries made into the functioning of important cartels (mainly German) and into the movement of cartelized prices and production in cartelized industries. It has been particularly aided by the increasing importance attached to the theoretical analysis of two sets of problems fundamental to the understanding of the effects of cartelization: the nature of monopoly as contrasted with free competition; and the char-

acter of the alternate expansions and contractions of business conditions.

ISOLATING THE SPECIAL CHARACTERISTICS OF COLLECTIVE MONOPOLY

As a result of such scientific endeavors, which are yet far from having reached a really satisfactory stage, the study of cartel problems has at least been provided with a sound basis on which to build a more consistent body of theory than before. Progress in this direction is much hampered by the inability of economists fully to neutralize the coloring effect of their liberal or collectivistic preconceptions. And this is the more the case because the phenomena under consideration are actively in the sphere of public controversy. In so far, however, as they agree upon the scope of the scientific inquiry and consult the same range of data, economists are gradually approaching a certain measure of agreement upon the more strictly economic effects of cartelization.

The monopoly problem was, from the very outset, the central issue on which the attention of those dealing theoretically with cartel problems centered, because monopolistic control of the market was considered the main objective of cartels. Thus the existence or absence of monopolistic tendencies became basic to the definition of cartels. These tendencies provided the commonly adopted test for distinguishing cartels from other associations of independent producers.

More recently when, side by side with cartels of the highly monopolistic type, many other less monopolistic cartels developed, the validity of the old definition was seriously questioned; and a considerable group of authors endeavored to extend the scope of the cartel concept to embrace any associations of independent

producers or traders interfering with conditions of the market.

There is no need to enter here into this partly terminological, partly conceptual question which has been widely discussed in German literature. Suffice it to say that it does not present a purely theoretical aspect: the considerable interest aroused by this issue is largely to be attributed to the fact that the definition of cartels established on grounds of economic reasoning is likely to be made basic to legislative action and judicial decisions. If the scope of the cartel concept is widened, especially by dismissing outright "monopolistic tendencies" as one of its essential characteristics, public policy loses its direct focus upon the monopolistic aspects of "cartels" as thus loosely defined. Consequently, thoroughgoing legislative action, inspired by anti-monopolistic sentiments, is somewhat less likely to be introduced for the control of cartelization.

The controversy turning on the definition of the cartel concept was rendered more intricate by the fact that, in practice, it is very often rather difficult to decide whether or not a given situation is monopolistic in nature. As already stated (page 8), free competition and monopoly are contrary notions. But just as for a range of shades extending from black to white it is impossible exactly to mark the borderline between the shades predominantly "blackish" and those predominantly "whitish," thus it is equally difficult to decide whether a given situation of the market is more of the monopolistic or of the competitive type. Monopolistic situations—waiving mention of buyers' monopolies—are typically characterized by more or less power on the part of the seller to regulate the supply of the goods concerned, to take his choice among a certain range of

prices. The limits set to the range of prices within which choice is possible, and to the period during which the choice can be operated, are essential in defining a specific monopolistic situation.

Thus the problems involved in the price policy of cartels were instrumental in reviving interest in the study of the various aspects of "limited" or "imperfect" or "monopolistic" competition—that is to say, of conditions of the market under which a substantial but more or less limited portion of supply is controlled by a single seller or an associated group of sellers.

On purely theoretical grounds, this issue had already attracted the attention of prominent economists, such as Cournot, Edgeworth, Pareto, and Wicksell. Theoretical analysis of a more mathematical type, carefully pursued more recently by other students, was paralleled by more realistic approaches. In addition to such "idealized" theoretical studies, some attempt had been made, especially by English and American economists, to study monopolistic problems with a closer approach to concrete reality. The subject matter of such studies was, however, mainly the specific American features of monopolistic combinations—in other words, the "trust movement" made up of combinations under unified financial control. On this account the problems studied were not quite the same as those arising out of the cartel movement. For further progress in analysis it was necessary to make careful distinction between single-handed monopolies and "collective monopolies" like cartels, marked by the varying circumstances and divergent interests of independent members, and by quite special relationships to market fluctuations.

This distinction has been drawn rather sharply in some of the more recent treatments of monopoly prob-

lems. Some of the contrasts have been displayed at an earlier point (page 85), and one or two points may usefully be reiterated here. By reason of a unified profit-making purpose corporate combinations can actively attempt the adjustment of costs to prices, while cartels characteristically attempt the adjustment of prices to the cost situations of their members. Integrated combinations of the vertical type in an important way attempt to establish *independence* of the market for a series of intermediate productive processes, while cartels are bound to strive for *control* of the market. Horizontal corporate combinations, even when striving for control of the market, typically arise under favorable market conditions, while the opposite is true of cartels.[1] Facts such as these raised doubts concerning the widely held opinion that the two types of combination are merely higher and lower expressions of the same trend of economic forces. While both are unquestionably related to the problem of monopoly, it has been found increasingly necessary to draw the most careful distinctions between their market-wise relationships.

Other special aspects of the monopolistic situation of cartels have secured general recognition. One of these is the existence of time limits, set by the duration of the cartel agreement. Cartel policy in exploiting market control may be much affected by considerations connected with facilitating the later renewal of the agreement. In this, collective monopolies decisively differ from more unified types. Another aspect, the existence

[1] Theoretical insight into the problems involved here was promoted by the development of the combination movement in post-war Germany. Cartels, which were thought of as "antiquated" institutions during the inflation period, rapidly recovered the ground they had temporarily lost and spread to almost all fields of industrial activity when the difficult task of adapting output to restricted markets faced employers, and when, in addition, sharp limits were set to credit expansion.

of price limits imposed by effective or potential competition, is less uniquely a cartel phenomenon. Any combination of whatever type, if not thoroughly in command of the market, is thus limited. But the special problems of meeting the situation by cartels are somewhat unique. The varying cost situation of the members affect the limits within which price policy can operate consistently with the attainment of cartel purposes, and the strategy and cost of defeating outside competition have to be specially adapted to the divergent interests of cartel members.

The often emphasized existence of "latent competition" going on among the cartel members has been made the object of closer analysis. It has been shown that this competition can properly be compared with the effects of free competition only as it results in lowering the costs of production. Very commonly, however, the efforts made by many members to strengthen their position within the cartel—especially by striving for increased quotas of output and sales—do not follow the line of cost reductions or of improvements of the quality of the goods produced; they may even involve enhanced costs consequent upon the purchase of quotas, exaggerated expansion of existing plants, and the like. If less efficient members are bought out and their plants closed down, the consequence need not be a reduction of prices, such as would ensue from concentrating production in the more efficient plants under conditions of effective competition. For, in the first place, the capital charges involved in the purchase have to be covered; and in the second place the prices remain under monopolistic control, and may not be closely adjusted to the marginal costs of efficient plants. Unreserved application of the term "latent competition" to the relations existing

among cartel members is therefore often misleading, since it is likely to suggest that the effects of cartelization are similar to those resulting from real competition.

The study of cartel problems has been illuminated, and at the same time been made more difficult in some ways, by progress in studies of industrial fluctuations. Doubt is cast upon the idea that disturbances of economic equilibrium can be explained, as classical economists were wont to do, by reference to external "frictions": and the view is supported that the ups and downs of business activity are produced by forces working within the economic system itself. Under such conditions monopoly theory is faced with the difficult task—which is far from having yet been successfully performed—of including monopolistic situations among the forces which by cumulative action affect the maintenance or restoration of economic equilibrium. One phase of this problem is the difference in the effects of monopolistic market control according to the phase of the cyclical movement in which control is being effected.

Thus cartel problems have come to be viewed from angles which before had hardly been seriously envisaged. The unique characteristics of collective monopolies have been isolated, and their unique relationship to the changing circumstances of markets established.

The peculiar occasion for the pursuit of collective monopoly is, as noted earlier, the existence of severe competitive pressures arising out of an over-capacity to produce, over-capacity being defined in business terms as the capacity to produce more than the market will absorb at prices which are profitable to the relatively high-cost producers. Unless over-capacity is so

great as to remain a constant feature even of periods of expanding market demand, the increase of demand tends to be accompanied by a less strictly monopolistic policy. As the relatively full exploitation of an industry's productive equipment approaches, the risk of severe competitive price-cutting, against which a cartel agreement is directed, diminishes. Cartel management is faced with constantly varying situations, and the effects resulting from its interference with production and prices are equally highly variable.

It is necessary to say that, in examining these effects, only a few broad generalizations can safely be drawn. The analysis which follows applies only to cases in which it can be assumed that demand periodically rises in a degree to permit relatively full utilization of capacity, or at least to relieve the market from severe competitive pressure on prices. This assumption is not universally applicable, owing to extraordinary conditions in particular industries; and when such conditions prevail, little can be said by way of generalization. Perhaps the one general valid observation in such cases is that the incentives which elsewhere are dominant only in depressed periods here remain constant.

CARTELS AND ECONOMIC STABILITY

One of the most controversial questions in cartel literature is whether, and if so to what extent, the course of business fluctuations is likely to be modified by cartel policy. Toward the end of the nineteenth century cartels began to be credited, especially by German writers, with the merit of introducing order into the "anarchic system of capitalist economy." During the heavy depression which marked the beginning of the twentieth century in Europe, cartel ad-

vocates insisted that, by restricting expansion of basic industries during the preceding boom, cartels had mitigated the shattering effects of the subsequent crisis.[2] These views were long reiterated without any secure backing in economic research or economic reasoning. Later investigation, especially since the World War, has required the modification of such views.

As already stated, experience goes to show that, in spite of the normal cartel objective of stabilizing the competitive conditions obtaining among the cartel members, constant far-reaching modifications of output capacity, costs of production, and size and economic strength of the allied concerns go on in the midst of the cartels. Consequently almost all experts agree on the view that, if cartel policy can at all be expected to exert equalizing or moderating effects on the course of trade fluctuations, such influence is likely to be due essentially to the endeavor on the part of cartels to stabilize prices.[3] Thus the issue involved is whether stabilization of prices as attempted by the bulk of strong German cartels, especially in industries producing important raw materials and half-finished goods, is apt to stabilize economic conditions.

Economic reasoning obviously leads to answering the question in the negative. If stabilization of prices is likely to be at all efficient in stabilizing general economic conditions—in itself a highly debatable point—the

[2] Deep-rooted divergences of opinions concerning the effects of cartel policy were revealed by the debates organized by the Association of Germany Lawyers (Deutscher Iuristentag) in 1902 and the Association for Social Policy (Verein für Sozialpolitik) in 1905. In many quarters strong administrative supervision of cartel activity was urgently requested but official hearings organized in 1903 to 1905 on cartel problems did not result in settling the issue, which seems to have lost much of interest during the following prosperity period.

[3] See A. Wolfers, *Das Kartellproblem*, p. 113.

"stabilization" in question must refer to the general price level as computed from a wide range of price data. It cannot possibly mean maintenance of prices of a given set of commodities which happen to be cartelized while prices of other goods ruled by free competition are left to experience free fluctuations which are exaggerated by the rigidity of cartel prices.

Whether or not a stable general price level is helpful in stabilizing economic conditions, flexibility of individual prices is certainly the circumstance most conducive to re-establishing economic equilibrium whenever it is seriously impaired. Inflationist as well as deflationist processes are marked by increased price dispersion. The prejudicial effects of such dispersion can be overcome only by the mutual readjustment of prices; and the rapidity of such adjustment is predicated upon the ease with which it can be accomplished. Thus the discount policy of central banks, aiming at reducing or checking exaggerated expansions or contractions of business, largely depends for its salutary effects upon ready reactions within the price system.

Such reactions, however, are hampered, or at least delayed, by cartel policy. Such policy in depression periods is not conducive to considerable reductions of costs of the cartelized products, and may increase them through restriction of output under conditions of degressive costs and through distributing available sales proportionately among cartel members, without regard to their efficiency.[4] Furthermore, even though cost reduction is widely accomplished by cartel members, prices are commonly held at a relatively high level in

[4] Insight into the adverse consequences of rigid quota systems promoted the attempt to devise more flexible methods of transferring quotas, but such schemes, being difficult to apply, have not been widely used. See W Hammesfahr, *Kartell-Beteiligungsziffer*, 1930, p. 218.

the interests of weaker cartel members. Unresponsiveness to discount policy is a marked feature of prices of monopolized commodities.[5]

If, during a period of market contraction, monopolized prices are kept constant over a lengthy period, and then only reluctantly and with considerable lags adapted to the general and rapid downward trend of free prices, a rigid cost element is introduced into all industries which are heavy consumers of cartelized products. Consequently prices charged by such industries, even though not cartelized, will be retarded in following the downward movement. The paralyzing effect of "bound" prices are thus most extensive when they exist in the raw materials and semi-finished goods industries, since rigidity is introduced into the cost elements of all later stages of manufacture.[6]

There are, of course, many cost elements other than those affected by cartelization which resist rapid change, including taxes, transportation costs, interest on long-term liabilities, wages in some circumstances, and so on. Cartelization merely adds to the instances of cost rigidity. In so far as it does so, it enforces correspondingly heavy price reductions upon goods little affected by monopolistic price policy. German price diagrams, based on comparative calculations of the trends of "bound" and free prices, permit the supposition that cartelization has substantially increased the dispersion of prices during periods of declining markets.[7]

[5] See A. Tismer, *Grenzen der Diskontpolitik*, 1932, p. 86.

[6] According to an estimate made in December 1933 by the German Institute for Business Cycle Research, in Germany no less than 34 per cent of the total turnover of industrial raw materials and semi-finished goods was ruled by "bound" prices.

[7] See Wochenbericht, *Institut fur Konjunkturforschung* (German Institute for Business Cycle Research), Dec. 6, 1933.

The burden imposed on economic life by securing profits for the cartelized producers is shifted by innumerable and intricate processes to the returns of other trades and to individual incomes. This is likely to result in threatening the existence of concerns which otherwise would be able to survive the depression. The burdens do not accrue entirely to members of uncartelized industries, since special cost situations may cause a policy of high prices and heavy reduction of output to be detrimental also to some cartel members. A presumption exists, not capable of full verification, that profits accruing to cartel members out of cartel policy will not offset the losses to others, and will therefore be detrimental to the economy as a whole in terms of accruing current income.

At least as price figures are charted upon a statistical graph, price dispersion also appears to be increased by cartel policy in periods of expanding markets. That is to say, the cartelized prices move upwards less far from the statistical base than do free prices. This creates the presumption, probably well founded, that buyers of cartelized products are benefiting from prices that are low relative to the favorable market circumstances of the time. In so far as this is true, it favors the expansion not merely of cartelized industries, but also of those into whose costs the prices of cartelized products largely enter. The conclusion may tentatively be drawn that expansion of production is exaggerated by cartel price policy for the reasons stated.[8]

[8] The difficulty which prevents too confident an assertion of that view is that price figures, showing merely percentage changes from some base, can in no way show what prices would have been if free rather than bound. A bound price which in good times rises relatively less than the general price level might be found to be, were comparison with an alternative competitive price possible, a high price in absolute terms.

The preceding discussion, though unduly brief, points to the conclusion that the stabilization of a certain group of prices by collective action, whatever its advantages for cartelized concerns, is unlikely under any circumstances to promote general economic stability, meaning by that phrase increased regularity of output, employment, sales, and consumption of goods. It is easy to understand that within an economic system ruled by the mechanism of prices, stabilization of prices of basic materials and half-finished goods, if pursued during a period of general price changes, is bound to result in enhancing fluctuations in the volume of production rather than in minimizing them.[9] Instead of stabilizing business fluctuations, cartels, especially those of basic industries, are likely to aggravate crisis and delay recovery, and probably force up expansion of output in prosperity periods, thus preparing the ground for more violent reactions than might obtain under a system of outright free competition.[10]

CARTELS AND CAPITAL ACCUMULATION

One of the most important elements in the analysis of the effects of cartelization is the relation of the movement to the use of investment funds. In an increasing degree professional economic opinion has been coming to the conclusion that it tends to "misdirect" capital, in the sense that it leads to certain forms of investment which at the same time result in no increase in the

[9] According to estimates made by the German Institute for Business Cycle Research, in Germany between 1929 and 1932 the prices of cartelized commodities experienced an average decline of 23 per cent whereas output of these commodities was reduced by as much as 46 per cent.

[10] While price experience under cartels, especially in Germany, has been rather fully put into statistical form, all statements concerning the effects upon productive capacity have to be carefully guarded, since there is no direct way of turning from price cause to productive effect. The qualitative theoretical analysis on the points involved is, however, hardly open to serious question.

national income and aggravate and prolong periods of depression.

One form of investment promoted by cartels is that of outsiders who wish to take advantage of the favorable situation created by the existence of the cartel. The motivation is not the same in all such cases. If the cartel supports prices at an attractive level, a new and efficient plant may be able to thrive under the protection of that level, especially since, not being bound by the cartel agreement, it may expand its sales by even slight undercutting. Again, the purpose may be merely to become such a nuisance that strong cartel members will buy it out at a handsome profit on the investment. Or the purpose may be to secure entrance to the cartel on very favorable quota terms.

Whatever the purpose, the bargaining power of such outsiders lies entirely in their power to threaten the cartel's monopolistic position. If this threat is ineffective and the cartel succeeds in ruining the interloping outsider, the capital investment of the latter is definitely wasted. But even though the outsider prospers in the shadow of the cartel, or alternately is so effective as to break down the cartel's power, it may still well be the case that the investment was not justified by the productive situation within the industry, but merely by the existence of a specific monopolistic situation.[11]

[11] As an outstanding example of over-investments due to cartel policy—in this specific case, cartel policy forced upon the trade by compulsory legislative measures—the conditions prevailing in 1927 in the German potash industry may be quoted. Consequent upon the Potash Law (Kali-Gesetz) of May 25, 1910, the number of quota holders increased from 68 to 164 in 1913 (including Alsace) and 228 in 1927 (excluding Alsace). Many mines were never intended for production, but merely for the sale of the right to exploit quota allotments. Of the 228 mines in 1927, not less than 129, holding approximately 45 per cent of the aggregate quotas, were entirely idle. Of the remaining mines, on an average only 60 were actually operated. The others were only kept equipped for reserve purposes. Such was the situation during

Certain economically unnecessary uses of capital may develop from the relations of members inside the cartel, irrespective of outsiders. When, for example, either cartel policy or the interests of certain members dictate the elimination of inefficient members, this must be done by purchasing and closing down the plants of the latter. What in effect happens is that new capital goes into the industry for the purpose of reducing its capacity to produce; and cartel price policy will be influenced by the purpose of covering the new capital costs. Since, however, developments of this sort may lead to concentrating production in highly efficient plants and may be accompanied by seeking larger volume at lower prices, it cannot be said in general that they affect customers or the economy as a whole as adversely as if such action were not taken. However, if we compare such action with a competitive situation, in the latter case no new capital is necessary to reduce the output of the industry. Losses of inefficient enterprises are fully borne by themselves. The advantages of improved efficiency are not used in part to neutralize the risks of such losses. The particular nature of the cartel as a kind of insurance institution for less efficient plants is made evident by this comparison.

Another effect of cartelization upon investment is

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a period of highest prosperity. Of total capital investments amounting to more than 2 billion odd marks, more than one billion had to be written off as a net loss. This loss was made up out of the profits of the trade, thus neutralizing the effects of far-reaching rationalization which, consequently, was not conducive to lowering prices. Of course, but for compulsory legislation, the large integrated concerns established within the cartel would undoubtedly have broken up the combination long before. (See R. K. Michels, *Cartels, Combines and Trusts in Post-War Germany*, 1928, p. 162 and K. Muhs, *Kartelle und Konjunkturbwegung*, 1933, p. 106). Other examples may be taken from the condition of the German cement trade, the cartels of which were persistently threatened by rising outsiders until the compulsory regulation recently decreed.

connected with the strategy of members in approaching a renewal of quota assignments. Members wishing to secure larger quotas may consider it a wise speculation to enlarge their capacity, thus placing them in a position to make valid claim to a larger quota. This position is especially fortified if, by reason of low costs and large capacity, the negotiator can threaten the cartel's existence by withdrawing.

The making of speculative investments in plant, whether for quota purposes or otherwise, is seen in the very strong tendency, especially among large concerns, to spend a substantial part of their accumulated profits in improving and enlarging their own plants. This tendency is not, of course, confined to strong firms which are cartel members. But in the case of cartel members it is accentuated by their relation to the cartel (with respect to quota allotments) and by the effects of the cartel (in securing them monopoly profits).[12] Such investments, derived from monopoly profits, do not involve the payment of adequate interest, as would be the case if the capital needed were borrowed. Moreover, the profits are withheld from the free capital market where the destination of accumulated savings is decided upon by the judgment of would-be investors and borrowers in a free market. The free capital market being thus impaired, interest rates tend to be higher than would otherwise be the case, and expansion of other lines of business activities to be hampered.

It is not to be supposed that cartel policy uniformly

[12] The discussion of the question of how the investment policy of the affiliated concerns is influenced by cartelization is surveyed, as far as the German literature is concerned, by Wolfers, *Das Kartellproblem*, p. 107. Though the majority of the authors quoted are inclined to lay the responsibility for over-investment in strongly organized industries at least partly at the door of cartel policy, further thoroughgoing research would be needed before a definite conclusion could be arrived at.

promotes over-investment in cartelized industries. Policy is often directed to quite the contrary purpose, deliberately attempting to prevent developments of the sort noted above. In so far as cartels are successful in preventing investments in improvements to plants which could maintain themselves on a competitive basis, the under-investment thus secured will enhance the profits of cartelized enterprises, and collaterally damage the profits and undermine the capital values in industries operating on a free market.

Rather closely connected with the matters under discussion is the much talked of question whether cartelization promotes rationalization. As commonly used the term "rationalization" has not meant primarily the normal continuous pursuit of economic efficiency through methods of cost reduction—though that idea is not absent from its connotations. In its larger meaning, it includes the further idea of adaptation of the whole structure of industries to fundamental changes in their market circumstances, which may be pursued either by unified profit-making groups, or through collective action, or conceivably through special relationships of the government to industries. In this wider sense it involves the simultaneous pursuit of productive efficiency, the long-run adaptation of productive capacity to the continuing needs of the market, and the short-run adjustment of output to market demand.[13]

[13] See the definition proposed by W. Meakin, *The New Industrial Revolution*, 1928, p. 17: "Rationalisierung was the term used to signify . . . continued rationing of output to keep it within the limits of current market demands, and a simultaneous reduction of costs." For a detailed history of the German rationalization movement see R. A. Brady, *The Rationalization Movement in the German Industry*, 1933.

The presence of the various elements noted in the rationalization concept often leads to some ambiguity in its use, since one element or another may furnish the particular context in which it is used.

Though there is no sufficient evidence for the statement that even far-spread cartelization has seriously impaired the introduction of technical improvements and of more efficient managerial organization, no satisfactory evidence has been advanced for the contention, made by some advocates of cartelization, that methods intended to introduce rationalization of this kind are increasingly promoted by cartels—apart from those of the finishing type—and that some sort of general transition is going on leading from the pursuit of outright monopolistic cartel policy to rationalization policy. Also, the general report of the committee charged with a comprehensive inquiry into production and market conditions of German industry, while it found that many cartels had included rationalization problems in their programs, arrived at no definite conclusion concerning their contribution to the movement; and it suggested that up to the present cartel policy could not be said to have adopted an adequate line of scientific research into industrial management, which might be made basic to a reform of the usual methods of price-fixing.[14]

However, if the term rationalization is used in its wider connotation, as outlined above, it involves, in the case of Germany after the war, as Warriner rightly says, "the vital question whether large-scale capitalist industry has the power of getting out from under the blow of permanent depression due to a contracting market or whether it must undergo the same operation as agriculture and domestic industry did, with no means of escape."[15] This question is, of course, far from having been sufficiently analyzed and can hardly be

[14] *Verhandlungen des Ausschusses zur Untersuchung der Erzeugungs-und Absatzbedingungen* . . . , I Unterausschuss, 3 Arbeitsgruppe, 4 Teil, p. 13.

[15] D. Warriner, *Combines and Rationalization in Germany*, p. 30.

solved under the changing economic conditions which, up to the present, have been a characteristic feature of Germany's post-war development.

The preceding observations, which might be extended to much greater length, will make it clear that cartel policies, in their diverse aspects, reach out into all parts of the capital market.[16] It cannot be said flatly that cartel policy discourages new investment in improved plant or the contrary. The circumstances are too varying for generalization. Two general points may, however, be confidently made. One is that the flow of investment funds is diverted into channels other than those dictated by the pursuit of competitive efficiency. The other is that some of the investment generated in response to cartel policy (both on the part of members and outsiders, and in other industries) is not in response to market demand, but represents an effort to turn the monopolistic situation occupied by the cartel to special forms of individual advantage. There therefore occurs something which may be termed waste of capital, which in countries poor in capital funds may be considered substantially prejudicial to the national economy.[17]

The effects upon capital investment promoted by

[16] Certain collateral consequences of a cartel upon other than the cartelized industries have been omitted from this analysis, but may be briefly noted here. Wherever cartel policy promotes over-investment in the cartelized industry, an increased demand is created for capital equipment produced by other industries, generating an expansion of output which would not occur under competitive conditions. Again, the amount of circulating capital needed for financing current operations in industries in later stages of production is affected by the prices fixed for cartelized raw materials and semi-manufactured goods, though probably not in a very important degree.

[17] In noting the promotion of economic waste through cartelization, there is no intention of exaggerating the matter by contrasting it with an idealized version of a wasteless competitive system. The capital wastes involved in competitive organization, as manifested in the real world, are well known. The purpose here is merely to isolate the circumstances especially conducive to capital wastes under a system of cartelization.

cartelization are in many respects different from those flowing from the existence of unified combinations of equivalent monopolistic strength. It is true that the latter may engage in strategic purchases of plants in order to close them down. And in so far as they pursue a monopolistic price policy, they also may be harassed by the rise of outsiders organized for the purpose of being purchased, or of prospering "in the shadow of the trust." Such developments are perhaps as typical of the American trust movement as they are of the German cartel movement. The principal difference is that the corporate combination is in a position to pursue a centrally controlled policy of rationalization, cost reduction, and adaptation of capital requirements to the trend of market demand. Plans of this sort can be integrated with the strategy of market control. The capital developments of enterprises within cartels are, on the contrary, likely to blend badly with the collective purposes of the cartel itself, since they are dictated by the individual and conflicting interests of the members.

It would therefore appear probable that over-investment is less likely under conditions of market dominance by corporate combinations than under cartel control. The difference is, however, merely a matter of degree. In either case, the general effect is that of redirecting capital investment along lines dictated solely by the effort to achieve and maintain a privileged position in the market at the expense of other economic groups.

Out of his investigations of pre-war developments in German industry, Warriner reaches the following conclusion:

> . . . the besetting evil of cartel organization was the stimulus it gave to over-investment in any branch whose market

had been genuinely controlled. Cartel after cartel in the heavy industries broke up under pressure of their members' demand for higher quotas. Other branches, above all, cement and lignite (in the Central German area) passed through the same vicious circle of price-fixing, expansion of works and foundation of new over-production and resultant collapse of the cartel.[18]

This precarious situation of cartels in the face of uncontrolled capital expansion is in striking contrast to the situation of corporate combinations of equivalent monopolistic power.

While the development of large corporate combinations has modified the situation in Germany since the war, it has not produced many combinations of a size to permit them to replace cartels as the dominant monopolistic element. What has happened in the heavy industries is that the cartel members have typically become fewer and larger. There exists a view, shared by Warriner, that cartel members, when few in number and controlling establishments extended over a wide range of processing, are less likely to expand their productive capacity inordinately if, by cartel policy, they are guaranteed quotas of a size adequate for the building up of rationalization schemes. The balance between large concerns and cartels is, however, not always maintained; and important elements of over-capitalization have clearly not been eliminated.[19]

The burdens resulting from misdirection of capital fall upon the economy as a whole. In so far as cartel policy is directed to maintaining returns on an exaggerated capital structure, it may mean the maintenance of higher prices in bad times on account of the investment

[18] Warriner, *Combines and Rationalization in Germany*, p. 50.

[19] The same, p. 52. Similar views are expressed by Brady, *The Rationalization Movement in German Industry*, p. 135.

activities in good times. But this is only one of the myriad ways in which the burden may be shifted.

CARTELS AND THE FLOW OF INCOME

Accumulation of capital and shifting of risk resulting from cartelization are obviously instrumental in modifying the size and distribution of the national income. The main questions involved here are two. First, do the increased profits accruing to the cartelized concerns or reduction of losses, as the case may be, increase the national income or do they leave it lower or substantially unchanged? Second, if one or the other of the latter alternatives obtains, how can the groups of income primarily affected by cartel policy be defined? The intricacy of these problems may account for the fact that hardly any attempts have been so far made to cope with them. Some purpose may, however, be served by noting a few special points.

As has been implied in earlier discussions, the effective pursuit of cartel policy is likely to diminish the national income in periods of market weakness and to prolong the period. Possibly, though more problematically, it may also be thought to increase national income in periods of market strength by reason of the moderate price policy typically followed, with correlative inducement of expansion.

Since cartel policy is oriented on protection of members of the cartelized industry in periods of market weakness, the successful pursuit of policy means that in such periods the industry is in a position to distribute to those dependent on it for income a larger relative share of the national income than would be the case without cartelization. The logic of full exploitation of monopoly power would lead to a similar result in

periods of market strength, but there is little evidence that at such times cartels follow, or have the power to follow, that logic.

In the degree that cartels succeed in diverting the flow of income toward the cartelized industry, it has to be done through increasing what, in the technical terms of income studies is known as the "value added by manufacture."[20] This is accomplished through a policy of high prices and "contrived scarcity."

Such evidence as is available supports the view that in practice cartels do in more or less limited degree achieve a net diversion of income into cartelized industries. Taking this result as given, there are two groups which have a possible stake in the increased revenue of a cartelized industry. One group is composed of investors in the industry, the other of persons whose livelihood derives from employment in it. The controlling incentive for cartelization reflects the interests of the investors in profits. Cartelization cannot, of course, guarantee generous profits to all members; but it can minimize or eliminate the losses of weak members, and increase the amount of differential profits accruing to strong members through superior efficiency.

Though there would be no cartelization without the prospective improvement in the profit situation, there is a strong likelihood that the workers in the given industry will benefit through cartelization. Relieved in some degree from competitive pressures, employers have not the same driving necessity to keep wage costs down, and may well prefer wage concessions paid out of monopolistic gains to engaging in a labor struggle. The general attitude of trade unions toward carteliza-

[20] This phrase means gross revenue minus amounts paid out to other industries for materials, equipment, and services.

tion can rather easily be explained by the fact that the members of successful cartels are, as a rule, less reluctant than other employers to comply with workers' demands for higher wages and better working conditions.

Thus cartelization is likely to become common cause for the employers and the employees of the industries concerned; and it is small wonder that workers' delegates appointed to participate in price-fixing deliberations of the German forced cartels (especially the coal syndicates) were ready to support the employers' proposals.

Again, the existence of wage agreements has frequently been referred to as an argument against public demand made upon strong cartels to reduce the prices of their products. Thus, in the much discussed "arbitration award" of 1931, an attempt was made to bring about a coupling of wages and price declines in the German steel industry, on the assumption that it is proper to have wages and prices lowered by the same percentages.

The distribution of incomes to the advantage of specific groups of capitalists and wage earners may thus be considerably influenced by cartel policy, but the lasting effects of such processes on the economic structure are likely to defy all reasonable estimates. It is, however, entirely clear that the diversion of income to particular groups, whether owners or workers, through exploiting a protected market position, is at the expense of other unprotected or less well protected groups. The advantage of occupying a monopolistic position arises out of the fact that there exist groups unprotected by monopoly to whom risks can be shifted. The advantages of cartelization to the groups concerned therefore are

dependent upon their existence in an economy which is still primarily competitive in character.

CARTELS AND INTERNATIONAL TRADE RELATIONSHIPS

The effect of cartelization on the home market is only one side of the problem. The second is presented by the effect on international trade relations. One need not linger on the obvious fact that protectionist trade policy has given lasting and strong support to the cartel movement, since the existence of a home market protected against foreign competition is as a rule fundamental to monopolistic price-fixing.

Increasing cleavage between the prices ruling on the home market and prices of the same products abroad is thus a characteristic feature of cartelization—at least in depression periods. If in addition the home market can be preserved from foreign competition by international cartel agreements, prices obtaining on the former may reach a state of outright isolation.[21] Tismer is right in stating[22] that for the last post-war decade during which the value of gold was appreciating, the level of cartelized prices in Germany was successfully maintained against the downward tendency of prices in terms of gold. The adjustment of the German balance of international payments was considerably impaired by this isolationist price movement.

Whenever export conditions of national industries are damaged by adverse events—by the erection or enhancement of foreign tariff barriers, by increased

[21] Thus, in July 1930, prices charged for various half-finished iron goods (bar iron, band iron, thick, middle, and fine sheet wire) were as much as 26 to 64 per cent higher on the German market than on the world markets, as the effect of international agreements covering the iron and steel industry.

[22] Tismer, *Grenzen der Diskontpolitik*, p. 116.

strength of competitors abroad resulting from technical improvements, by changes of the monetary standard, and the like—adaptation of costs on the part of the exporting industries is inevitable if outlet on foreign markets is to be retained. This process may be facilitated by deflationary credit policy. Price-fixing, however, if extended over a range of important basic materials and semi-manufactured commodities, may place serious obstacles in the way of such a policy. Export industries consuming large quantities of cartelized products will be prejudiced against competitors on markets abroad.[23]

Such adverse effects of cartelization may, on the other hand, be offset by the export activities related to monopolistic control over the home market. It was stated in a previous section that "dumping," in its looser meaning, that is to say, discrimination of prices as between the home market and the markets abroad, is deeply rooted in the very nature of cartels;[24] and even within the national boundaries such discriminations are quite regularly applied whenever the market is partly open to outside competition. The heavier the restrictions imposed on the cartelized concerns as to their production for the monopolized market, the stronger is the incentive to increase their sales on foreign markets in order to get the advantage of degressive costs. As long as profits derived from the monopolized markets are increased by the reduction of costs per unit of output consequent upon enhancing the total volume of production for export, profits can be forced up by underbidding competitors on the disputed markets.

[23] This drawback can be at least partly neutralized by the granting of export bonuses on the part of the cartels. See p. 74.

[24] See p. 72.

Thus cartel policy tends to increase price dispersions on international markets as well as on the home markets.

The phenomenon of discriminatory prices between home and foreign markets is not an invention of the cartel system. The incentive to such discrimination exists for single enterprises enjoying the protection of adequate duties in the absence of a cartel. Even under cartels the actual discrimination is practiced by individual members rather than by the cartel itself, except in a few instances of strong syndicates. All that the cartel does is to accentuate the tendency to such discrimination, causing the volume of products sold abroad at lower prices to be larger than would be the case if the output salable on the home markets were not restricted.

The varied economic effects of international price discrimination have been made the object of searching analysis by competent authors, and could not be gone into here except at undue length. Because of the fact that cartels accentuate discrimination, cartel advocates have been at some pains to find merit in discrimination from the point of view both of the impetus given to domestic production and of benefits to foreign consumers; and even go so far as to deny that, apart from exceptional cases, it takes the form of dumping in the most strictly defined sense of sales below the average unit costs of production for the whole output marketed at home and abroad.

Critical observers point to the fact that protective duties, cartels, and dumping policy are related elements of a system tending towards increasing economic antagonism between different countries, impairing international trade relations, and retarding the solution of world-wide depressions. Export practices promoted by cartels, it is argued, combined with the cartel price

policy applied to the home market, are characterized by the endeavor to render prices independent of the costs involved in the production of the cartelized products; on the home market the prices charged are higher, on the markets abroad they may be lower than costs. The tendency of prices to be adjusted to marginal costs regarded as essential to the smooth functioning of the price system, is thus rendered ineffective. The working of forces tending towards a general adjustment of prices to costs and *vice versa* is thwarted, and general measures of monetary and credit policy are counteracted, since their effectiveness is largely dependent upon the unhampered functioning of the price mechanism.

Under such circumstances import duties are likely to assume a function largely divergent from the primary objective they are intended to serve, which is protective and defensive in nature. Under competitive conditions the protective function will permit domestic prices to equal the inland marginal cost of production plus import duty and freightage only as long as home production is not sufficient to cover the demand of the home market. Whenever this condition has passed, competition among home producers will tend to reduce prices which may eventually, if adequate reduction of costs is accomplished, fall even to the level of world market prices. If, however, supply of products is deliberately curtailed by cartel policy, prices can be kept persistently at a level permissive of full exploitation of the protective duty, which thus turns out to be instrumental in securing lasting monopoly profits.[25] Though cartels, as has been noted, do not commonly exploit full monopolistic powers, the analysis of the character

[25] See A. Feiler, "Der Gestaltwandel der Handelspolitik unter dem Einfluss der Kartelle," *Magazin der Wirtschaft*, 1930, II, p. 2109.

of their benefits from import duties has a validity which can hardly be questioned.

Again, if strong control over the home market is made fundamental to the policy of forced exports at low prices, import duties, primarily meant to protect national industrial activity against superior external competition, are performing another unpremeditated function. They are made efficient weapons of economic warfare between the industries of different countries. High protective tariffs, basic to the dumping of exports, are likely to promote the erection of increased tariff barriers by other countries to protect their industries from the attacks of foreign competitors. Thus tariffs, cartels, and dumping policy may be conceived as integral elements of the policy of "economic imperialism" which seeks to enhance national economic power at the expense of other nations competing on the world's markets.

It is in this warlike conception of economic relationships that the significance of international cartel agreements can be most clearly seen. Viewed from this angle, such agreements may be said to be instruments for delimiting the spheres of warfare and securing each national industry a certain portion of the world market adjusted to its strength in international strife. This strength is largely determined by the degree of control it is in a position to exert over its national market, and protective duties may thus be conceived as covering a further function: the task of supporting national cartels in the struggle to be allotted, by international cartel agreement, as high a quota of world production as possible.[26] Protective duties, paving the way for mo-

[26] See the statement made in 1929 by the Economic Consultative Committee of the League of Nations: "Experience has shown, it was argued, that the regulation of competition which results from industrial agreements does not

nopolization of the home market and for dumping, may even be divested of their primary protective function, when by international understandings home markets are reserved for the national cartels and, consequently, price policy relevant to these markets is rendered largely independent of the level of duties. The limits set by this level cease to be effective if, by international agreements, foreign competition is kept out of the way. Though the effects of international cartelization may thus outrun protective tariff policy, it appears, as Professor MacGregor says, "to be part of the same system of thought, rather than as being cosmopolitan in its conception of production."[27]

Nevertheless the importance of this "cosmopolitan" conception is emphasized by some economists who see in thoroughgoing international control of production the possibility of mitigating antagonistic national tendencies. Such expectations played a notable role in the reports prepared by distinguished experts for the International Economic Conference of 1927. Almost all of them—with the outstanding exception of G. Cassel—agreed on the necessity of giving the international cartelization movement free course, and expressed strong belief in the stabilizing and regulating functions which international cartels might accomplish if properly managed.[28] The Swiss economist, E. Grossmann, even

invariably lead the parties to consent to tariff reductions, since combines are often concluded on the basis of the commercial possibilities resulting from the protection afforded by the existing tariffs, and a change of tariffs modifying these possibilities would be regarded as jeopardizing the combine itself." (Quoted by the *General Report on International Industrial Agreements*, Ser. L. o. N. P., 1931, II, B, 21, p. 29.)

[27] D. H. MacGregor, *International Cartels*, Ser. L. o. N. P., 1927, II, 16, p. 4.

[28] A similar attitude was taken by four industrial experts whom the Economic Committee of the League of Nations had requested to make a study of the problem of international industrial agreements. See the report submitted in 1931 by these experts, quoted on p. 10.

went so far as to define the role of international cartels in the following words:

> The division of labor on international lines, the advantages of which have so long been vaunted by free traders but which cannot be obtained by diplomatic negotiation, will at last be brought about by co-operation among producers. International cartels will be able to rationalize production in a way impossible in the present state of affairs . . . they will also, as Mr. Edward Filene suggests, be able to bring about very great technical improvements without having to replace medium sized or small undertakings by gigantic enterprises, simply because each factory or workshop will be responsible for the production of certain specialties—often of a single component part of a given product . . . .[29]

Such views are hardly substantiated by dry facts. International cartel agreements are, in their origin and development, fostered initially by the same economic conditions which are instrumental in the case of national combinations of this type. They aim at stabilizing the existing competitive situation on an international scale; or, if such a far-reaching goal is unattainable, at least at securing for each national group uncontested control over its home market. The prospect of constructive policy of the planning type envisaged in the passage quoted above is especially slight when the control of international cartels reaches only a limited percentage of the world's output capacity, leaving large parts of the international market to the unrestricted working of competitive forces.[30]

[29] E. Grossmann, *Methods of Economic Rapprochement*, Ser. L. o. N. P., 1927, II, 69, p. 20.

[30] Of the industries which have been made the object of international cartelization, only a few in number have been covered by world-wide agreements: potash, sulphur, aluminum, copper, probably also rails and steel tubes and incandescent lamps. With other industries, producers of a limited number of countries arrived at international understandings. Such is the case in the mining industries with lead, zinc, magnesium, bismuth, antimony, nickel, quicksilver, ferro-manganese; in the iron and steel industry with pig iron and various kinds of steel and steel products; in the metallurgical in-

Though, as already stated, no constructive principle can yet be discovered in international cartelization, the impressive list of industries involved suggests that this movement made considerable progress over its pre-war development.[31] In judging the numerical strength of international cartelization it is not to be overlooked that, in surveys dealing with this question, the term "cartel" is often used in a very vague sense, denoting almost any type of combination of independent enterprises concerned with international market problems. The majority of international "cartels" are to be qualified as more or less loose price associations. Among those belonging to the strict cartel type, regional organizations established to safeguard the national markets are of course prevalent. They are often combined with a distribution of external markets or with some sort of regulation of total output, the national groups being assigned their shares by means of a quota system though price-fixing on disputed markets may not be held advisable.[32] Of this latter type was the agreement in 1926 between the raw steel cartels of France, Belgium, Luxembourg, Germany, and the Saar, and extended afterwards to other European countries. Output exceeding the quotas allotted was not strictly prohibited, but adequate contributions were to be paid per ton of excess production to an equalization fund, out of which those groups were to be compensated which had not exhausted their quotas. Underbidding

dustry with sheets and wires; in the chemical industry with dyestuffs, nitrogen, superphospate, etc.; in the textile industries with velvet, silk, sewing thread, and silk finishing; and in other industries with cement, glass, linoleum, paper, ceramic products, and the like.

[31] See the table showing, for a score of European countries, the participation of trades in international cartelization, at the end of Fischer and Wagenfuhr, *Kartelle in Europe*, 1929. The *Balfour Report* estimated pre-war agreements at about 114.

[32] See p. 52.

on contested markets thus amounted practically to purchase of quotas. Agreements in other lines of the iron and steel industry (rail making, tube manufacture, rolled wires manufacture) were equally based on quota schemes.[33] The highly centralized international copper cartel adopted a quota system combined with price-fixing.[34]

A striking feature of much post-war international cartelization has been the dominant part taken by large corporate combinations in distributing international markets. Such is the case with iron and steel products, tubes and rails, copper, nickel, quicksilver, zinc, aluminum, several chemical products (nitrogen, dyestuffs), glass, and incandescent lamps. Those observers are probably right who believe that in the long run the movement will get a stronger support from increasing vertical and horizontal concentration of industry than from national cartels embracing many concerns of various size and pursuing a rather conservative policy.

Within the schemes established by international cartelization, powerful concerns very often tend to strengthen their position and to expand their activity by purchasing undertakings in external territories with a view to closing them down or extending their control into other territories. A similar purpose may be served by creating branch establishments in foreign countries. The danger of "dominating foreign influence" which may arise from such procedures is especially felt by

[33] The raw steel cartel expired in 1932, but in June 1933 a new international agreement was made according to which export quotas, instead of output quotas, were allotted to the members and selling agencies were formed for a number of rolled goods. The tube cartel was dissolved in 1935.

[34] Price-fixing policy of the international copper cartel differed remarkably from that commonly adopted by similar combinations. It aimed at full exploitation of expanding markets by forcing up prices, but after 1929 this system experienced a complete breakdown.

countries which are poor in capital and ruled by strong nationalistic tendencies.

Post-war international cartelization presents specific aspects related to the fact that many agreements owe their existence to the territorial changes brought about by the peace treaties. Economic areas, the industries and markets of which had been closely interwoven by long evolutionary processes, were torn asunder by the erection of tariff barriers along the new political boundaries. Thus the home market was largely reduced for many industries and a considerable portion of the capacity which had been adapted to the former market conditions was made dependent upon sales abroad. Over-capacity was increased by the tendency on the part of the states to create within their political boundaries additional industrial capacity capable of covering the entire domestic demand. This operated to shut out concerns which, by the new partition of Europe, had become foreign competitors. Such were among the disastrous results of the dismemberment of the Austro-Hungarian empire.

Hence various cartels were formed designed to bring into a closer union the productive and selling activities of economic territories now disrupted by tariff barriers.[35] Such agreements covering industrial organizations in Austria, Czechoslovakia, Poland, and extended in various cases to Germany, Jugoslavia, Rumania, and other Balkan states, apply to the production and distribution of iron, steel plate, wire rod, glass, porcelain, glue, and the like. As a rule competition is regulated as far as the mutual home markets are concerned; in other cases (paper, felt hats) the Balkan markets were made the

[35] See E. Hantos, *Mitteleuropaeische Kartelle im Dienste des industriellen Zusammenschlusses*, Berlin, 1931.

object of regulations. In Western Europe the annexation of Lorraine by France resulted, for the Lorraine heavy industry, in the loss of its previous outlets and led to the creation of the pig-iron cartel embracing French, Belgian, and Luxembourg producers.

General disturbances of international competitive conditions due to revolutionary shake-ups of currency systems also contributed to increasing international understandings during the post-war period.

The expectation that international industrial affiliations would provide a lasting basis for attempts at political *rapprochement* among European nations has been profoundly shattered during the present depression, which has largely fostered tendencies towards national economic isolation.[36] The period which has elapsed since the short post-war boom has, for most countries and industries, been too heavily laden with the task of adapting their productive capacity to rapidly changing market conditions to permit clear-cut implications being drawn from the trend of international cartelization, the development of which is beset with special difficulties. These result from far-reaching divergencies between different countries as to the statutory and administrative regulation of cartel activities; from the intricacies involved in adequate compromises for conciliating the divergent interests of various national groups; and last but not least, from the fact often complained of that important elements of uncertainty are introduced into international trade relations by the

[36] Thus the fear expressed in some American quarters lest international industrial affiliations leading toward a "United States of Europe" might menace the commercial interests of the United States proved ill founded. The view was expressed by J. Donaldson even before the depression that no effective economic coalition was probable. See his *International Economic Relations*, 1928, p. 341.

lack of long-term commercial treaties on which to build up firmly established and durable industrial understandings. During the present crisis many international cartels have broken down or been obliged to modify the agreements, since market conditions have been altered by tariff increases, by departure from the most-favored-nation clause, and by introduction of preferential trade conventions and of import quota fixing. The fixing of import quotas has, however, in some cases been based on understandings between national industries, and the respective cartels have been called to assist public administration in executing the convention.

If national cartels, especially those of heavy industries, are not likely to be conducive to a general stabilization of economic conditions, the same is probably true of their international counterparts. They may be helpful in reducing the evils arising from lasting world-wide so-called over-capacity of certain industries, but they can hardly be expected to provide constructive schemes for improving the unbalanced system of present-day world economy. The danger arising in periods of heavy depressions from artificially isolating the price movement of important elements of production may even be increased by systems of monopoly, extended on a world-wide scale, over a considerable range of important cost elements.

THE PARADOXICAL SITUATION OF COLLECTIVE MONOPOLIES

A certain analytical inadequacy characterizes much of the existing treatment of such centrally important cartel problems as the effects upon the accumulation of capital, upon the distribution of income, and upon general economic stability. In particular, the advocates of cartelization quite generally lack adequate insight

into the conditions under which general economic equilibrium is likely to be maintained, and to be restored if seriously impaired. In terms of general economic effects, cartelization clearly magnifies the tendency toward rigidity, which is antipathetic—in a system of private enterprise—both to the full utilization of productive resources and to the minimization of economic instability.

What can unreservedly be said to explain cartelization amounts to acknowledgment of the undeniable fact that in periods of heavy and prolonged depressions—not to speak of exceptional cases in which certain industries have definitely lost important parts of their markets—there is involved extensive reduction in the value of private capital. Such losses can be lessened by collective action designed to reduce the risk involved in falling prices and reduced demand. Under such conditions the tendencies conducive to restraint of trade are so strong that they gain great political strength which permits them to undermine an economic policy of unrestricted enterprise. Similar situations may arise in the competitive struggles waging on world markets.

The existence of a close correlation between the development of cartelization and depressed market conditions once being granted, it is rather difficult to subscribe to the view held by many German economists, adherents of the school of historical reasoning, that cartels and kindred combinations are preparatory to the evolution of a "higher" type of economic order than is presented by the functioning of a system of free competition. If co-operative action of competitive enterprises is deemed to deserve a higher place on a comparative scale of various types of economic behavior

than is assigned free competition, the standard chosen for passing the judgment on cartels does not rest on a just estimate of the degree of productive energy which collective monopolies are likely to display as compared with the working of economic forces under free competitive conditions. Whether or not the choice of other standards derived from sociological considerations—appreciation of common action as contrasted with the pursuance of individual interests—might result in assessing specific values to combinations of independent concerns, is a question which is to be decided upon grounds of general social politics. But even in this case the varying attitude of collectivist combinations, as influenced by the course of cyclical movements, is carefully to be kept in mind. The question is to be raised as to the merits of an economic philosophy imbued with characteristics of a behavior resulting from business motives in the face of restricted markets, depressed trades, and national barriers to free international intercourse.

Economic reasoning cannot but recognize the paradoxical fact that collective monopolies, though conducive to increased rigidity of the economic system and, consequently, impairing the re-establishment of general economic equilibrium in depression periods, are nevertheless the "legitimate" offspring of such periods, in the sense that they are generated by the need for economic self-defense and for avoiding self-destructive competitive strife. The capitalist system—probably like any other economic system—is rich in such instances of contradictory forces operating within the system. It is this very fact which, despite the most competent economic analysis, makes the choice of disinterested standards of public policy subject to differ-

ences of opinion among reasonable and well-informed persons.

This paradoxical situation is brought into clear relief when an attempt is made to outline the legislative and administrative problems arising out of the development of cartelization whenever and wherever this development has attained irresistible strength, as has been the case especially during the post-war depression periods. These problems will be presented in the following chapter.

CHAPTER VI

CARTELS AND THE STATE

It follows from the earlier analysis of cartel policy that the activity of cartels involves coercion of various kinds. Obligation to comply with the rules and provisions set up by a cartel may be enforced on reluctant cartel members (internal coercion), or may be imposed on customers or outside competitors (external coercion). Internal coercion may consist in enforcing contractual agreements. External coercion may be indirect—that is to say, designed to create economic conditions which will defeat opposing forces. The effects of cartel policy on competitors and consumers may be varying in nature, according to the degree of monopolistic control over the market, the commodities controlled, the general conditions of business, and so on.

Thus public policy with regard to cartelization is faced with at least three sets of problems, each of which is general in nature and by no means limited to cartelization. There is, first, the question of the extent to which restrictions of freedom of economic action imposed by voluntary agreements should be lawfully permitted. The principle of freedom of trading is engaged here in a conflict with the principle of freedom of contract. This conflict is roused by all cartel conventions; but it may be equally provoked by other contracts (sales of good will, exclusive trade agreements, and the like).

There is, secondly, the question whether and to what extent extra-legal economic coercion exerted by combined action on reluctant cartel members, customers,

and competitors is to be considered lawful. Economic coercion of this kind is a constituent part of cartel policy as such. But it may be performed by other kinds of combined groups (trade associations, financially interrelated corporate groups, trade unions, etc.), or even by powerful individual concerns.

The third problem involved is the monopoly problem strictly speaking. It turns on the general question of the extent to which the creation and maintenance of monopolies should be tolerated. Here again, the problem is not limited to cartelization, but comprises monopolies of any kind, especially such as are attempted by large unified combinations.

Under common law these three problems were embraced by the concept of "restraint of trade," but in the process of juridical development extended over more than a century each of them took separate and specific aspects. The separation of the issues is still more characteristic of those countries which were not ruled by common law, but had to take legislative measures in order to clear the way for jurisdiction. There has been a tendency in such countries to hold economic coercion resulting from combined action and enforced under certain circumstances compatible with the principles of public policy. Similar changes have been noticeable in the attitude taken by legislative and judicial bodies towards monopolistic regulation of production and prices.

Quite apart from the provisions and rules relevant to "restraint of trade," there developed a body of law and business morals by which the principles of "fair" competition have been defined and "unfair" practices condemned. The concepts of "restraint of trade" and "unfair competition" may be distinguished by con-

sidering the former as referring to restrictions enforced by concerted action and the latter as applying to practices condemned by law or business sentiment which are used in competitive struggles between individual concerns. If this definition is adopted, the problems involved in unfair competition, though partly connected with attempts at monopoly, can be left entirely aside in the present writing.[1]

MAIN TYPES OF STATE POLICY

An adequate insight into the varying attitudes of governments towards cartelization may perhaps best be reached by discerning three main types of behavior, each of which corresponds to a specific line of economic and social philosophy. They may briefly be termed the atomistic, the organizing, and the authoritarian types. There exist of course many mixed types, especially between the two first-named ones, and there may be variations within any one of them. But the distinction proposed should nevertheless be helpful in explaining the main issues.

Atomistic Policy

One type of policy, which may be called "atomistic," grows out of the conclusion that the best economic results are thought to be obtainable through the competition of individual business units, largely unhampered by state intervention or monopoly. The rules of common law, as developed under the philosophy of

[1] It may be mentioned that this limitation of the meaning of "unfair competition" does not agree with the usage adopted in establishing "codes of fair competition" in this country under the National Recovery Administration. The notion of fair competition was so far extended as to embrace compliance on the one hand with the regulation of certain labor conditions and on the other with certain restrictions of free competition resulting from co-operative action of competitive enterprises. There is no need for adopting this terminology in a comparative international analysis.

laissez faire, reflect this attitude. Restraint of trade, that is to say, serious interference with individual liberty of action in trading, is held against public policy.

In practice this general type of policy confronts the problem, already mentioned, of how much emphasis shall be laid upon unrestricted freedom of the individual to trade, and how much upon unrestricted freedom to enter into contracts. Since one of the things which can be contracted away is the freedom to trade, full acceptance of the latter emphasis might under some circumstances facilitate cartelization, rather than insure the maintenance of competition. To correspond with what is here meant by the atomistic type, public policy need not make collective agreements completely impossible, but it must maintain its essential orientation on preserving the benefits of competition. It can not therefore be accurately called a policy of *laissez faire*, since it is obligated to intervene to limit the attempts of groups of individual enterprises to escape from the competitive régime.

In this respect, the policies of the United States and England may well be compared. Until quite recently the United States, following the atomistic policy as strictly as any other country, has heavily emphasized the maintenance of competitive conditions of trade, with collateral restriction of individuals to enter into collective trade agreements or to interfere with the market freedom of others in any way. This is the policy of the anti-trust laws.[2] The scope of the present discussion need not include an analysis of American legislative and judicial development in relation to industrial

[2] It is of interest to note that the example set by the United States in its anti-trust legislation has been followed by several of the British dominions: the Union of South Africa, Canada, Australia, and New Zealand.

combinations; but it must be noted that it has been of a sort to outlaw all attempts at industrial cartelization.[3]

Great Britain, no less than the United States, has followed a policy based on the merits of the competitive system. In so doing it has not, however, passed restrictive legislation corresponding to the anti-trust laws. The door has thus been left open for rather broader development of collective action. The particular difference is that some agreements which in the United States would be criminal are in Great Britain merely unlawful, in the sense that they are not subject to coercive enforcement as contracts; and some other such agreements are enforceable contracts.[4]

Since the repeal in 1844 of any ancient statutes dealing with contracts in restraint of trade, the courts have been left without any specific direction in dealing with cases involving monopolistic tendencies.[5] They came to establish a doctrine of public policy based on the distinction between reasonable and unreasonable restraint of trade. "The tendency of the decisions is not to look upon agreements for the protection of a business, although competitors may be seriously injured thereby, as being an unreasonable restraint of trade, so long as lawful measures are taken in carrying out such agreements, and the opinion prevails that justifiable means of protection should be considered valid. Agreements

[3] The recognition and regulation of monopoly in industries "affected with a public interest" represent phenomena outside the scope of a cartel discussion.

[4] "In the United Kingdom combinations operating in restraint of trade are, though not criminal, unlawful, if shown to be against public policy, as public policy is understood by English courts, where these words are construed in a somewhat narrow and technical sense." *Report of Committee on Trusts*, Ministry of Reconstruction (Cd. 9236), 1919, p. 11.

[5] Transitory provisions, passed during and immediately after the World War with a view to preventing undue price increases (Defence of the Realm Act, Profiteering Act, 1919), expired after short duration.

held to be void as being in restraint of trade have been held only to be illegal in the sense of not being enforceable."[6] Moreover, "the courts, it would seem, will now enforce a contract to prevent competition and raise prices, provided that the terms of restriction imposed are reasonable and made upon real and *bona fide* consideration."[7]

Thus in *North-Western Salt Co., Ltd.* v. *Electrolytic Alkali Co., Ltd.* (1914, A. C. 461) it was held that "unquestionably the combination in question was one the purpose of which was to regulate supply and keep up prices. But an ill-regulated supply and unremunerative prices may in point of fact be disadvantageous to the public. Such a state of things may, if it is not controlled, drive manufacturers out of business or lower wages and so cause unemployment and labour disturbance. It must always be a question of circumstances whether a combination of manufacturers in a particular trade is an evil from a public point of view."

Equally unequivocal is the decision by the Judiciary Committee of the House of Lords in the Adelaide case (*Commonwealth of Australia* v. *Adelaide Steamship Co.*, 1913, A. C. 781):

It can never, in their Lordships' opinion, be of real profit to the consumers of coal that colliery proprietors should carry on their business at a loss, or that any profit they make should depend on the miners' wages being reduced to a minimum. . . . There is in this respect a solidarity of interest between all members of the public. The Crown cannot, therefore, in their Lordships' opinion, rely on the mere intention to raise prices as proving an intention to injure the public. To prove an in-

[6] W. A. Sanderson, *Restraint of Trade in English Law*, 1926, p. 103.

[7] The same, p. 112. See also F. H. Levy, "A Contrast between the Anti-Trust Laws of Foreign Countries and of the United States," *The Annals*, January 1930, p. 125.

tention to injure the public by raising prices, the intention to charge excessive or unreasonable prices must be apparent.[8]

The general tendency of judicial decisions, as implied in these and kindred decisions, is to take the view that combined action agreed upon under depressed trade conditions, with a view to adapting prices to costs of production, is to the advantage of public interest and therefore to be considered as reasonable restraint of trade, whereas "a contract in restraint of trade, though reasonable in the interest of the parties, may be unreasonable in the interests of the public, if calculated to produce that state of things which is referred to by Lindley and Bowen, L. I. I. as pernicious monopoly calculated to enhance prices to an unreasonable extent."[9]

Under these decisions the relation of prices to costs of production may thus be taken to represent the essential standard for determining the interest of the public involved in cartel agreements. The more sympathetic attitude adopted towards the latter for some years past by English Courts[10] can in some degree be explained by the general post-war conditions of British economy which are marked, in important lines of trade, by lasting losses of outlets on markets abroad. On the other hand, owing to the uncertainty of their legal position, agreements regulating production and prices

[8] This decision is quoted as an instance of common law jurisdiction though the case in point was ruled by the Australian Industries Preservation Act. But the act explicitly provides that the restraint of trade charged shall not be deemed unlawful if the defendant can show that it was "not to the detriment of the public and not unreasonable." The interpretation of these exceptions rests with common law.

[9] *Nordenfelt* v. *Maxim Nordenfelt Guns and Ammunition Co.*, 1898, A. C. 535.

[10] See *Review of the Legal Aspects of Industrial Agreements*, Ser. L. o. N. P., 1930, II, 11, p. 30.

are likely to be informal "honorable understandings" or "gentlemen's agreements," apart from associations created in conformity with the provisions of the Trade Union Acts, 1871 to 1917. But such legal standing as can be secured by corporations, friendly societies, and co-operatives is not accessible to cartels.

The court decisions quoted are not to be taken as indications of a definite shift in administrative British policy. Few countries have been more thoroughly imbued with the ideas which underlie atomistic policy, and the competitive régime has been considered the normal and desirable state of economic organization. The typical elements of British policy have therefore been in marked contrast to policy which adopts a largely favorable attitude toward cartelization, influenced by ideas of the merits of collective action which are hardly in harmony with the ideas supporting atomistic policy.

It is true, however, as shown above, that some degree of cartelization has developed under various court decisions. Moreover, under the pressure of heavy and lasting over-capacity in important lines of export industries, British administrative policy has recently shown a distinct move in the direction of fostering co-operative action for adjusting output and output capacity to the depressed condition of markets.[11] This policy is to be included among the types presently to be discussed.

The Organizing Types of Policy

It is difficult to find a wholly adequate expression for denominating the type of policy which tends to be tolerant and indulgent with respect to cartelization without actively promoting it. But, as is shown by experi-

[11] See p. 274.

ence, the combination movement and monopolistic tendencies have been largely favored by this attitude, which has thus turned out—at least indirectly—to have an organizing effect. What is here therefore called the "organizing" type of state policy is characterized by distinct, though in most cases indirect, promotion of cartelization by public administrative authorities without clear-cut legislative or judicial action assigning cartels a definite position in the economic structure.

It is very difficult to discover a clear and consistent line of economic reasoning underlying this policy. That it is influenced by the ideas of economic liberalism may be seen from the fact that the state as a rule refrains from interfering with the development of cartelization. But that it does not subscribe to the underlying competitive philosophy is shown from the failure to engage in active restraint of monopolistic forms of concerted action. Without the necessity of actively intervening to remodel the economic structure, administrative policy merely recognizes the legitimacy of the desire of business groups to mitigate the hazards of competition. Thus, in practice, strong support is lent by state policy to the organizing tendencies, which are permitted to establish powerful machinery for market control and, by virtue of their economic and political importance, are even allowed to exert a strong influence on the trend of general economic policy.

Time and again, in almost all countries in which this attitude towards cartelization has been adopted, the critical issue has been raised whether the existence of such powerful combinations within the body economic should be tolerated, unless their activities were closely controlled by adequate administrative organs. This question was eagerly discussed, even before the war, but

any attempts to devise efficient supervisory machinery proved abortive. In exceptional cases compulsory cartelization was used as a measure of organizing policy in order to secure the exploitation of a national monopoly on the world market. Such was the case with the prewar German potash cartel and the Italian sulphur cartel. But, on principle, organizing policy has typically been permissive only, and not related to compulsory cartelization. French authors especially have been utterly opposed to any legislative and administrative measures by which the full independence of cartels and kindred combinations might be impaired.[12]

The wavering attitude of organizing policy towards cartelization has, however, been strongly challenged in various countries during the present depression, and has given way to outright promotion of cartelization tendencies. Even compulsory cartelization has been resorted to for some severely depressed industries, as a provisional and transitory expedient intended to support them in highly disorganized markets. Compulsory cartelization can be considered a constituent element of organizing policy only when coercion by the state is exclusively meant to bring a dissenting minority of the industry into line with the supposed general interests of the industry as represented by the demands of the majority; and when the specific objectives to be reached and the measures to be adopted are left to the decision of those concerned, without authority of government administrative agencies to use their discretion in modifying the agreements proposed. Viewed from this angle, legislation of this type is in sharp contrast not only to the authoritative state policy presently to be discussed,

[12] See P. d. Rousiers, *Cartels and Trusts*, Ser. L. o. N. P., 1927, II, 21, p. 21.

but even to the code-making process as adopted in the United States under the National Recovery Administration.

Under a policy of this sort, based on the desires of a majority group in the several industries, no constructive idea, and still less any clear economic reasoning, can be discovered as being fundamental to the policy. It lacks a clear-cut approach to the intricate problem of how to reconcile the principles underlying the free working of economic forces with the obvious failure of the price mechanism to secure a smooth working of these forces. Whether or not compulsory cartelization, introduced under the pressure of abnormal business conditions, will turn out to be a lasting feature of industrial organization, or whether it will lead to important modifications of industrial structure, it is impossible to foresee. Both issues will be decided upon, in the last resort, by the future course of economic events, in combinations with the conditioning political circumstances.

Among the countries which essentially follow the organizing policy, some show a striking discrepancy between the legal position of cartels and their actual importance for economic development. While few such countries have had competitive ideas so thoroughly ingrained into their systems of legal ideas as have those subject to the British common law concept of "restraint of trade," most of them have had special legislation on monopolization which has in the past rendered the legal position of cartels precarious. On the whole, however, the amount of economic coercion held consistent with "public interest" has exceeded the amount which would be tolerated under the "restraint of trade" concept. Cartel agreements, though commonly not enforceable at law, have therefore been able to attain a stronger

foothold through administrative and judicial tolerance. And this has more recently developed into active approval, even to the point mentioned above of leading in some cases to compulsory cartelization.

An interesting instance in point is the situation which obtained with regard to cartels and kindred combinations in the former Austrian monarchy. It prevails up to the present with slight modifications in the succession states, Austria and Czechoslovakia. In both countries the legal position of cartels has, on principle, been ruled by a law enacted in 1870, at a time when cartels were almost non-existent. This law was intended to prevent employers' and workers' organizations from using concerted action to influence wages and prices. Thus it declares to be legally inoperative any agreements between industrialists or merchants with a view to raising the prices of commodities to the prejudice of the public. In virtue of this anti-monopolistic provision, cartel agreements, though not expressly prohibited, are considered unenforceable, according to the general practice of the courts; and organizations created for controlling the market of commodities produced by their members cannot be established under the regulations applying to legally acknowledged associations, companies, and corporations.

The legal status of cartels in the countries just mentioned superficially has the appearance of a striking resemblance to their status under English law. Legal provisions and their judicial interpretation do not, however, tell the story of extra-legal processes going on in real life. There was, up to the end of the World War, no need for British administrative policy clearly to define its attitude towards cartelization since serious attempts to gain control of the market by collective agreements

were almost unknown. The situation was quite different in the former Austrian empire where the market conditions—slowly expanding home outlets fairly well protected against competition from abroad—were such as to promote the checking of internal competitive struggles by the adoption of co-operative schemes. So strong was the rapidly progressing impact of these tendencies that no serious effort was made to prevent them from materializing in numerous cartels and cartel-like associations existing outside the sphere ruled by enforceable legal provisions. Legislation proved to be incapable of coping with this situation. As early as 1897 the Austrian government submitted to the parliament a draft bill intended to establish strict administrative supervision of cartels regulating production and sales of consumption goods. Time and again, kindred bills were proposed and discussed, without, however, resulting in legislative action. Hence the introduction and maintenance of collective monopolies enjoyed the tacit approval of official policy, and promoters of cartels backed by the strong support of majorities in the industries concerned have not been lacking in devices for obviating the difficulties involved in the ill-defined legal situation. These difficulties have been met by legal advisers who have worked out an elaborate system of methods providing for extra-jurisdictional settlement of mutual claims which might arise under cartel agreements; and this system seems to be so highly efficient that important representatives of Austrian heavy industry are inclined to prefer the present state of extra-legal cartel existence to any explicit recognition and regulation.[13]

[13] See the report submitted by Dr. Weiss-Wellenstein to the 35th meeting of German Jurists (*Verhandlungen des 35, Deutschen Juristentags*, 1928, Vol. I, p. 202).

In Czechoslovakia, by recent legislation mainly directed against undue price increases and constraints in business relations, a greater measure of control of cartel activities by public authorities is provided for.

The situation is largely the same in Poland. For lack of a uniform codified national legislation, various parts of the country have been subject since the war to such provisions as were in force at the time of their national amalgamation, that is to say, to German, Austrian, and Russian statutes respectively. But the fact that since the end of the war cartelization has developed in Poland to an extent hardly equalled by any other country undoubtedly suggests that the legal situation hitherto obtaining in the country has not placed difficulties in the way of the organization and operation of cartels[14] which in important cases have been strongly favored by the country's commercial policy.

Italy, up to the introduction of outright authoritarian policy by the Fascist government, was also to be reckoned in the group under discussion. Unlimited free competition was never made basic to the economic order by Italian legislation, and creation of monopolies was held by the courts to be consistent with statutory laws. Policy was not, however, clear cut. On the one hand, supplementary to commercial usages based on the concept of free competition, the specific notion of "public order" was introduced into the legal system in ways which secured to consumers far-reaching protection against monopolistic price-fixing and economic coercion.[15] On the other hand, the objects of associations or "syndicates" were recognized as lawful if designed to protect

[14] *Review of the Legal Aspects of Industrial Agreements*, Ser. L. o. N. P., 1930, II, 11, p. 79.

[15] See Valerio de Sanctis, *Das Recht der Kartelle in Italien*, Berlin, 1928, pp. 39 ff.

their members against abuses or irregularities on the part of trade competitors. Cartel agreements as such, even if concluded for considerable periods in conformity with the provisions of the Civil and Commercial Codes, were held enforceable. Combinations of this kind might take the form of outright companies as provided for by the Commercial Code.

While in the countries so far mentioned development of cartelization did not meet with serious difficulties, in spite of deficient special legislation, in France important obstacles had to be overcome before cartels could enjoy the liberty of action needed for the realization of their purpose. In 1791, during the French Revolution, the principle of freedom of trade and industry had been made an integral part of the constitution; and in addition, by the Chapeliers Act (June 1791) all agreements and even any meetings for the discussion of common interests either by employers or workers were declared unconstitutional and contrary to liberty and to the Declaration of the Rights of Man. Moreover, any departure of prices from those determined by "natural and free competition," if brought about by combination or concerted action on the part of the main sellers of a commodity, was a criminal offense according to the Penal Code (Articles 419 and 420).

The first important breach in this rigid legal system of free trading was effected by an act of March 1884, authorizing the creation of trade organizations formed with a view to studying and defending industrial, commercial, and agricultural interests. This act, modified in 1920, hardly legalized the creation of cartels and kindred combinations aiming at control of markets;[16] but certain combinations were permitted to acquire legal stand-

[16] I. Lapergue, *Les Syndicates des Producteurs en France*, 1925, p. 64.

ing under the forms of associations or "contrats innommés" as provided for by civil and commercial legislation. Thus the "comptoirs" as well as the "commercial associations" developed,[17] without being formally acknowledged by special legislation. The restriction imposed by the anti-monopolistic articles of penal legislation was step by step reduced by an increasingly liberal interpretation of these provisions. There was at the beginning of this century a marked tendency for French courts to regard as void and contrary to the freedom of trade industrial agreements comprising the manufacturers of a given commodity, when the purpose of such an agreement was to force up prices. At present the *de facto* monopoly is no longer a criterion of the illegality of the agreements. Contrary to the doctrine which had been basic to the "restraint of trade" concept, the opinion gained headway that a "punishable offence is committed only when the object of the agreement is to manipulate prices so as to make "excessive profits."[18]

This interpretation, which marks a decisive stage in the evolutionary process of economic and juridical reasoning, was sanctioned by the amendment of Article 419 of the "Code Penal" enacted in 1926 after prolonged public and parliamentary discussions. In the "Exposé des motifs" by which the introduction of the bill was accompanied, it is argued that the bill clearly distinguishes between unlawful combinations, as defined by the proposed wording of the article, and agreements which, "by regulating competition in order to bring it into line with market requirements, aim solely at preserving a normal equilibrium between production and consumption, at stabilizing the market and regulating

[17] See p. 276.

[18] *Review of the Legal Aspects of Industrial Agreements*, p. 45.

labor, by preventing risks due to over-production and sales at a loss and which are, moreover, often necessary for the purpose of safeguarding our national interests in our relations with similar foreign combines."[19]

This statement intimates the essential reasoning of cartel philosophy. The persuasive power of the arguments advanced in favor of cartelization was supported in the parliamentary debates by considerations derived from broad national political aspects. In defense of the amendment the following passage of a treatise on combinations was quoted with great emphasis by the parliamentary *rapporteur*:[20] "At the present time, industrial combination is a vital matter for France. Faced as she is with Germany which has practically completed the organization of all her industries into combines, with the United States which is making great strides in this direction, and with Great Britain which is following the same course, French industry, if it remains unorganized, is bound to succumb beneath the weight of these gigantic international combines." Thus in France as in other European countries, cartels, outlawed for more than a century as prejudicial to public interest, are nowadays considered, by official French policy, not only as important instruments for establishing the balance between productive and consumptive capacity but also as indispensable armaments of national economy in the struggle for international markets. Development of cartelization is to be promoted by legislation and only abuses of monopolistic power resulting in excessive profits are to be prevented.

Under the impact of the depression, this policy was

[19] The same, p. 47.

[20] Leon Mazeaud, *Le probleme des unions de producteurs devant la loi française*, 1924.

carried further early in 1935, when a bill was adopted by the French lower chamber introducing in effect a system of enforced cartelization. This system is meant to be an emergency measure limited to industries severely hit by adverse market conditions. The essential arguments advanced in favor of the bill centered on the idea that the price mechanism, and consequently the free play of economic forces, has lost the ability of securing self-regulation of production in harmony with the needs of the markets—if not forever, at least during the present heavy depression. Hence common action ruled by the interests of the whole trade is, if need be, to be made obligatory as against the opposite individual interests of a minority of the industry.[21]

The bill provides that, if a group of employers representing, as a rule, two-thirds of all concerns and three-quarters of the total sales of the industry, during the preceding year has adopted an agreement for the purpose of regulating trade conditions for a limited period, such an agreement can be made binding upon all members of the industry by governmental decree. The agreement may include a wide variety of measures for adapting production to the situation of the market, at home and abroad (including reduction of output, hours of work, and inventories; restriction of production to existing plants; conclusion of collective labor agreements; fixing of minimum standards of quality; assessment of contributions; and flotation of loans). In order to avoid far-reaching governmental interference with economic life, a special "Arbitration Committee" composed of the heads of independent industrial, commercial, and financial organizations and institutions (in-

[21] See "Debats parlementaires No. 17," *Journal Officiel*, Feb. 13, 1935, pp. 447 ff.

cluding the Governor of the Bank of France and the General Secretary of the Trade Union Federation) is to be charged with the task of examining the merits of the proposed agreement and submitting the results of its findings to the government. Unless the Committee's proposal is strictly affirmative, the government is not to be empowered to declare the agreement binding. Control of the execution of the agreement is placed with the appropriate executive department of the government; and any modification of the agreement is made dependent upon following the same procedure as prescribed for the initial stages. A general regulation of industrial combinations, suggested in many quarters and discussed time and again, has not been attempted.

In Belgium the legal position of cartels is almost the same as in France. Cartels are permitted to operate without any interference on the part of authorities. The anti-monopolistic provisions of criminal law are exclusively directed against the use of fraudulent means in influencing prices and against attempts to bring about "abnormal" rises or falls of prices. The interpretation given by the courts to these provisions is rather favorable to industrial agreements, so far as they are intended "to regularize and promote production and to prevent a fall in prices with unemployment and ruin as the result of unbridled competition."[22] Also, the government's attitude towards cartelization is decidedly of the organizing type. As in France, during the present depression economic forces operating in favor of market restrictions have been so strong that, in January 1935, a royal decree was issued providing for compulsory cartelization on almost the same lines as those adopted by French legislation. Severely depressed trades can be

[22] *Review of the Legal Aspects of Industrial Agreements*, p. 27.

authorized to enforce their agreements on reluctant members.

In adopting a policy deliberately in favor of far-reaching cartelization, most continental European countries were largely influenced by the example set by Germany since the beginning of the present century. Germany has been, so to speak, the laboratory of the cartel movement, both in the actual experiments and in the development of a cartel philosophy.

The problems involved have been as eagerly discussed by jurists as by economists. Maintenance of free competition has never been near to the hearts of German economists and jurists, who, largely influenced by the reasoning of the historical school, have considered organization far more appropriate to German mentality than isolated action.[23] Other arguments derived from sociological rather than from purely economic considerations have played an important part in cartel discussions, and have received strong support from beliefs concerning the stabilizing tendencies of cartelization.[24] Moreover, the apparent advantages secured by powerful cartels to the national industry in the struggle for foreign markets have militated in favor of the combination movement. Though the legal validity of cartel agreements has hardly ever been questioned and the organizing forces have generally been favored, there has existed no clear-cut principle of economic or social philosophy providing for definite delimitation of state interference with economic life. Hence legislative proposals, advanced during three decades, ranged from legal systems investing the state with full power of control and direction of the cartelization movement to guarded

[23] See p. 94.
[24] See p. 105.

measures for preventing abuses of monopolistic power without interfering with the autonomous development of organizing tendencies. Apart from exceptional periods, German legislation followed the latter course, up to the establishment of the Third Reich.

Since the validity of cartel agreements did not meet with any legal obstacles in Germany, it was possible to make use of the legal forms of associations and corporations provided for by the civil and commercial codes, where something more than mere contractual agreements was desired. As a rule, a system of double contracts was chosen, the first ruling the mutual relations of the members, the second, institutional in nature, securing the competence of the central agency of the cartel.[25] Settlement of internal disputes, as well as of differences arising between cartels, was preferably entrusted to private mediation boards efficiently organized by large industrial associations. This system of extra-judicial arbitration largely contributed to establishing a consistent body of rules upon which to build up a powerful cartel policy. Thus there developed within the framework of general civil and commercial law an unofficial jurisprudence backed by definite principles of cartel philosophy.

Though the cartel type of monopolistic market control was by no means inconsistent with generally held views, cartel operations were open to criticism from two different angles: from the point of view of private interests which might be injured by coercive measures brought to bear upon reluctant cartel members, outside competitors, and customers; and from the point of view of public interest, which might be endangered by artificial regulation of production and prices adapted to the

[25] See p. 47.

special interests of strongly allied groups of producers.

Criticisms of the second type were particularly sharp during the period of heavy depression which marked the first years of this century.[26] But a comprehensive government inquiry made from 1903 to 1906 into the cartel situation, especially in the mining and heavy industries, did not supply sufficient arguments for reformatory legislative action—the less so since the advocates of reform were at a loss to devise appropriate administrative machinery for supervising cartel activity. The favorable official attitude may partly be explained by the fact that during the course of the inquiry depression had given way to a prolonged prosperity period, which enabled the cartelized industries to expand operations in both domestic and foreign markets. The claims of those who asked for special protection of individual undertakings against coercion by cartels were partly assuaged by an amendment (in 1909) of the legal provisions against unfair competition. But this legislative action did not prove to be so effective a weapon against coercive cartel policy as was generally expected when it was taken. Also, the general provisions of the Civil Code (Article 826) granting compensation claims in the case of wilfully caused damage were hardly adequate to exclude all cases of aggressive cartel policy resulting from the struggle with outside competitors.

The general official attitude towards cartelization changed but little after the war. The so-called "Cartel Decree," issued in November 1923 by virtue of extraordinary administrative powers conferred by the Reichstag, was the outcome of an inflation period, and was primarily intended to prevent "selling-terms associations" from shifting to the consumers the risk involved

[26] See p. 120 n.

in the rapidly vanishing value of the currency. By title, however, the decree was wider, being directed against any "abuses of economic power." Though not including provisions for detailed regulation and supervision of cartel activity, it did introduce a series of regulatory measures. These included provisions: (a) to prevent the execution of cartel agreements or resolutions endangering the common welfare of business as a whole (Section 4);[27] (b) to grant protection to cartel members by permitting them to withdraw from the agreements without prior notice for reasons of weight (Section 8); (c) to make the application of sharp means of pressure against cartel members, outsiders, or customers dependent upon preliminary juridical approval (Section 9);[28] (d) to prevent generally the misuse of powerful monopolistic positions. With this purpose in view the competent judicial body (the Cartel Court) was authorized to declare publicly that all contracting parties were granted the right to withdraw from a contract which had been found to be detrimental to business as a whole or the common welfare (Section 9).[29]

[27] Such operations are: restriction of production or sales in a manner not justified by "national economy," undue increase of prices, exaction of extraordinary charges for inflation risk, inequitable restriction of liberty of trading through exclusive purchase or sales agreements or through the fixation of discriminatory prices and conditions. The introduction into the decree of an article providing for preventive measures in such cases was mainly due to the conditions prevailing during the inflation period. In fact, interference with cartel agreements or resolutions in the interest of common welfare were resorted to prior to the establishment of the National-Socialist régime only in a few cases. As a rule the control took the form of preliminary instruction and guidance by the competent administrative authority.

[28] By coercive measures of this kind are understood: realization of securities or bonds deposited by cartel members and forfeited by virtue of the agreement, imposition of boycotts, and the like.

[29] Though the provisions mentioned under (d) included offenses committed by unified combinations (trusts and the like), in practice cartels exclusively were made the object of proceedings. The decree is therefore quite commonly

The Minister of Economy was assigned the role of intervening in cases in which public interests were at stake; and a special Cartel Court was created to deal with lawsuits arising out of the provisions of the law.[30] In view of the special nature of the cases with which the court was to deal, it was given a special composition unlike ordinary courts of law, including among its associates representatives of different economic interests and an expert expected to represent the public welfare.

This new quasi-judicial machinery was not meant to encroach upon the functions of the private mediation boards established by the central industrial organizations, but only to supplement them in cases in which these boards, for lack of means of enforcing their summons and decisions, were unable to settle a controversy. Intervention with cartel operations, as authorized by the provisions referred to above under (a) and (d), was resorted to only in exceptional cases, owing to the difficulty of defining "the interests of economy as a whole" or "common welfare," which these provisions are intended to protect. The bulk of litigation brought before the cartel courts centered on the right granted cartel members (under Section 8) to withdraw from the cartel for reasons of weight without giving notice in advance. But the fear expressed in some quarters that by a liberal interpretation of the term "reasons of weight" the validity of cartel agreements might quite generally be shattered was not confirmed by experience.

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called the "Cartel Decree" in spite of its more far-reaching terms. For a more detailed statement of the contents of the decree, see R. K. Michels, *Cartels, Combines and Trusts in Post-War Germany*, 1928, pp. 49 ff., and *Review of the Legal Aspects of Industrial Agreements*, pp. 55 ff.

[30] The authority of the government to control cartel policy, especially price-fixing, independently of the Cartel Court, has been strengthened by a decree issued on July 26, 1930.

Thus, owing to the manner in which the law was applied by the responsible administrative and judicial authorities, it was not strongly opposed by the partisans of the cartel movement and did not impair the spread of cartelization. Criticism from the cartel viewpoint mainly turned on the question whether jurisdiction in cartel affairs might not better again be transferred to ordinary courts instead of being exercised by a special court;[31] while those opposed to the rapid increase of monopolistic tendencies insisted upon the creation of a central Cartel Board charged with the task of supervising cartel operations in order to prevent the adverse effects they might have on economic development. But there is no need to enter into a discussion of these issues which have lost their importance on account of the economic policy later adopted by the National-Socialist government.[32]

In Norway a more comprehensive attempt was made to establish machinery for the purpose of supervising monopolistic operations within the limits of organizing state policy. General and continuous control of prices, which had been initiated during the World War, is the main objective of the Norwegian law of March 1926. To this effect a system of registration is provided for, based on compulsory notification and extended not only to cartels and kindred combinations, but also to individual enterprises, especially large-scale companies which are in a position to exert an important influence on the prices of goods or services.

[31] This view was especially stressed by the resolutions of the 35th meeting of the Association of German Jurists held in 1928. By another set of resolutions it was recommended to confer upon the Minister of Economy limited supervisory powers over cartel activities. A committee of experts was, moreover, proposed to assist the Minister in an advisory capacity. See *Verhandlungen des 35, Deutschen Juristentags*, 1928.

[32] See p. 183.

Thus the Office of Control, created by the law and invested with the power to require and check any information it may deem desirable, is permanently aware of cases arousing suspicion of unlawful monopolistic operations (excessive prices and profits) or undue restraint of trade (exerted by commercial boycotting, exclusive agreements, or price discrimination). The actual enforcement of the prohibitive provisions of the law is, however, entrusted to a special Council of Control consisting of a president and four members, and assisted in matters of local or regional importance by communal committees of control which took the place of the former local price commissions.

Though the law is not meant to prevent cartelization, conclusion of long-term cartel agreements and enforcement of the obligations entered upon by the cartel members are seriously impaired by it. The executive powers conferred upon the Council of Control include the right to dissolve combinations if their activities are regarded as undue.[33]

In Poland the government has submitted a draft law to Parliament, providing for administrative supervision of combinations in mining, industry, and trade. Supervision is to be facilitated by compulsory registration with a Commissioner of Cartels, appointed under the Minister of Trade and Industry. A special Cartel Court is to be charged with the task of proceeding against combinations suspected of violating the public welfare. Also, in Czechoslovakia an official draft law is under discussion by which far-reaching powers of control are to be conferred on the administration.

The preceding survey elicits the striking fact that,

[33] For a more complete statement, see the *Review of the Legal Aspects of Industrial Agreements*, p. 72.

while cartelization has proceeded apace in continental Europe, nowhere (except possibly in Norway) has there been developed anything like an effective governmental procedure for the supervision of the activities of voluntary cartels. This is rather amazing in view of the dangers lurking in private monopolistic organization. Nor is it the result of overlooking the existence of those dangers, or of failure to canvass measures of control. But, out of the extended history of cartelization it can confidently be said that no general criteria of how to distinguish licit from illicit monopolistic activities have emerged; and no scheme of supervision has been devised which would be both effective and compatible with the fluid exercise of private business judgment in detailed situations. Voluntary cartelization under an organizing state policy, though accepted as a preferable or unavoidable alternative to free competition, is nowhere definitely placed in the scheme of national economic life.

Authoritative Policy

Cartelization as a strictly economic phenomenon grows out of a situation in which individual initiative has wide scope. It represents essentially the self-protective gestures of groups of enterprises to minimize individual competitive risks through combined action. It is indigenous to a system of economic freedom. The two types of public policy described above represent two differing attitudes toward such developments. The atomistic policy is in principle opposed to "restraint of trade" and monopolistic tendencies. It envisages the relatively full maintenance of the competitive system. The organizing policy tolerates anti-competitive developments; may consciously facilitate them; and in some

cases actively extend them by enforcing the terms of voluntary agreements upon persons who do not voluntarily subscribe to them. Both types of policy are, however, built upon ideas of the scope of governmental action which do not assert the active responsibility of the state for bringing economic activity into forms of organization subordinated to the collective purposes of the state.

In contrast, what is here called "authoritative" policy is related to schemes of political thought which magnify the collective purposes of the state and charge the state with active use of its supreme powers in shaping the national economy. The ends of state policy may, of course, be conceived in varying terms, so that authoritative policy implies no particular set of objectives. In the present connection, cartel policy will be examined in relation to two prevalent, and largely opposite, tendencies; one relating to socialistic ends, the other to the ends of the so-called "totalitarian state."

The socialistic objective with respect to cartels is to make them basic to the structure of a "regulated economy." If free competition between independent concerns could permanently be superseded by the operation of strong combinations, each of which would definitely control production and sales of all undertakings within a given industry, the way might be paved for setting up a central co-ordinating authority. Institutionally, this might facilitate the substitution of some sort of public ownership of the means of production for private ownership, the justification for which has commonly been placed upon the need for private initiative under a system of free competition. Thus the creation of compulsory cartels, especially in the basic industries, has seemed to many socialists to be the best start for slowly

remoulding the present economic system to a socialist pattern.

State policy in none of the Western European nations has been dominated by fixed socialistic objectives. But the existence of politically important socialist parties has influenced policy, and facilitated the development of cartelization. Socialistic tendencies were, above all, strongly instrumental in Germany in the enactment of the so-called Socialization Laws by which, during the first years after the end of the World War, cartelization was forced upon certain lines of industry, especially the coal-mining industry. They were also instrumental in shaping the administrative forms, as for example the introduction of workers' and consumers' representatives in the administrative body set up to determine the price of coal.[34]

After socialization schemes had fallen into oblivion in Germany, their influence remained behind in the institutional scheme of forced cartels, for which the government worked out an efficient system of administrative supervision.[35] What remained, however, was a special manifestation of the organizing policy, analyzed in the preceding section of this chapter.

Socialist policy toward cartels lies entirely in the field of tactics for promoting the advent of the socialist state. Were a socialist state to be achieved, there would of course be no cartels which are by definition combinations of privately owned enterprises. Though not perhaps to be regarded as a socialist state, strictly speaking,

[34] The idea underlying the creation of this machinery was obviously based on the erroneous doctrine advocated by some socialist authors that the process of pricing commodities as performed on open markets could adequately be replaced by majority decisions passed by representatives of those groups primarily interested in the sale of these commodities. No sound economic argument can be advanced in favor of this idea.

[35] See S. Tschierschky, *Kartellpolitik*, p. 120.

the Soviet Union has nationalized its industries in such a way that a discussion of cartelization need take no account of Russian industrial organization.

In turning to the second manifestation of authoritative policy, it must be admitted that the idea of the "totalitarian state" is not easy to state briefly and abstractly. It is better, therefore, to make clear at the start that the discussion is to be confined to those concrete forms of governmental structure which have sprung up in Italy and Germany. The only clear thing about these forms is their empirical existence. They are giving rise to new intellectual systems of political and economic philosophy which amount in effect to *ad hoc* defenses of the new forms of government. The primary characteristic of the governments is the exercise of dictatorial powers, divorced from the customary procedures of representative governments; and the primary element in their economic philosophies is the subordination of economic action to the collective, or rather organic, needs and purposes of the state as envisaged by its dictatorial government.[36]

The principles of authoritative policy toward cartels, under the forms of government just mentioned, are not clearly defined. These governments have imposed themselves upon given sets of economic circumstances, and in general have not proceeded to any rapid or radical reorganization of the business substructure of the state. Cartelizing tendencies seem on the whole to have

[36] No attempt will be made to outline the elements of "totalitarian" political philosophy, which have in fact only been developed in connection with the Italian Fascist government. In this connection, it should be noted that the term "Fascism" has quite definite connotations and is marked among other characteristics by the fundamental idea of building up the state out of a system of inter-dependent corporations each of which covers a definite field of professional activity. The widespread application of the term "Fascist" to all dictatorial tendencies in government is highly inaccurate.

been accepted as an effective means for promoting national economic interests. Looked at in the large, the primary difference in practice between the authoritative and the organizing policies appears to be that the former includes a rather greater readiness to practice coercion on unwilling elements, including in some cases majority groups within industries. This may commonly be thought of less as a difference of view concerning the merits of cartelization than as the assumption of a relatively active, rather than a relatively passive, attitude which is made possible to a dictatorial government released from some of the impediments to the exercise of coercive power. It is, so to speak, an attribute of the dictatorial mind.

A government vested with dictatorial powers is in a position to act more directly and effectively in imposing cartelization on unwilling minorities, or on whole industries; in regulating the expansion and use of productive capacity; in pursuing definite social policies, such as the encouragement of small-scale or large-scale industry respectively, through controlling the terms of cartel agreements; in co-ordinating the activities of different cartels; and in exercising supervisory control over price-fixing and other aspects of cartel policy.

The resort to cartelization is in no sense a necessary corollary of the totalitarian state. State policy may be pursued through varying schemes of economic relationships, all the way from free competition to government ownership and differing from industry to industry. As an approach to fuller subordination of economic affairs to nationalistic policy, it is, however, not surprising that forced cartelization and closer supervision of voluntary cartels should have emerged as characteristic phenomena in the new dictatorial governments, especially dur-

ing a period marked by a heavy and prolonged depression.

In Italy, though the Fascist idea of the "stato totale," or integrated state, does not involve any fundamental alterations of the present capitalist system, it aims to render national economy an essential weapon for promoting national power and supremacy. Therefore state intervention is assigned a prominent place in the development of economic life. To the extent that powerful combinations can be regarded as useful means for strengthening national productive forces, they are favored by the Italian government, and, if need be, even forced upon industries. In this connection, the General Fascist Federation of Italian Industry and the various national trade federations subordinated to it are called to play important parts in an advisory and intermediary capacity.

Intended as a means for overcoming the depression, Italian legislation in 1932 rendered cartelization compulsory for any industry, if proposed by a qualified majority of the employers concerned (70 per cent of the employers controlling at least 70 per cent of output, or a smaller percentage of employers controlling at least 85 per cent of the total production). Here again the position of the national federations is of prime importance. It is a characteristic feature of the plan of regulation that authorities deliberately avoid prescribing details and laying down minute directions for the operation of compulsory combinations. The rules and regulations proposed by the industry concerned are to be approved by royal decree; they are bound to include the constitution of a Board of Appeal called to decide issues arising out of the cartel's activity. Moreover, the competent minister is authorized to exert a permanent con-

trol over this activity, thus safeguarding national interests against possible abuses.[37] With a view to co-ordinating all cartel activities, such cartels as may exist by virtue of voluntary agreements are bound to inform the competent minister of rules and regulations.

The system of controlling production was strengthened by additional legal provisions (issued in May 1933) to the effect of restricting the erection of new plants and the enlargement of existing ones in almost all important lines of industry. Any considerable increase of productive capacity is thus subject to authorization on the part of the government.[38]

In Germany, after the advent of the dictatorial National-Socialist government (Hitler government), by virtue of legislative provisions issued in July 1933 the competent administrative authority (the Minister of Economy) was empowered to "federate enterprises into syndicates, cartels, conventions, or similar agreements or affiliate them to already existing organizations of this kind in order to regulate market conditions." This authority is vested with an undefined right of control over, and interference with, cartels and kindred combinations, and with the right to impose restrictions upon the expansion of productive capacity and the use of

[37] It should be stated that the number of cartels operating under this law is very small, and that the policy of the Fascist government toward cartels on the whole corresponds to the organizing policy discussed earlier with an added tendency to exercise control over the terms of cartel agreements. This calls attention to the lack of strict logical congruity in the descriptive titles of the three types of policy discussed. The third type, called "authoritative," is isolated by reference to the type of government which adopts policy, rather than by the policy itself, and is not therefore exactly co-ordinate with the other two, called "atomistic" and "organizing." It may overlap them, and at the same time include elements foreign to them.

[38] There are other important elements in Fascist economic policy which have been widely publicized, but which are not relevant to the present discussion. This is especially the case with the system of "corporations" for regulating the relationship between employers and employees.

existing capacity. Moreover, it is entitled to make decisions directed against cartel agreements, and thus to assume a jurisdiction which by previous legislation had been assigned to the cartel court. It is interesting to note that, by another amendment of the Cartel Decree of 1923,[39] boycotting is explicitly declared lawful if directed against undertakings which are managed by "untrustworthy" persons or are selling at prices which cannot be justified from the point of view of the common weal.

This legislative action, according to its advocates, carries out the supreme economic principle of the National-Socialist philosophy that private interests are to be subordinated to the organic purposes of the state. Thus the interests of each individual concern are to be adjusted, by way of adequate market regulation, to the interests of the trade as a whole, while the latter are to be subordinated to the interests of the national economy.[40]

The authoritative policy shifts emphasis entirely away from the rights of individuals to free action in trading. It equally removes from monopoly all invidious meaning as bearing upon the restriction of the freedom of individuals. The tests of policy no longer derive from individualistic habits of thought. In Germany, the more extreme advocates of National-Socialist doctrine have gone so far as to condemn the whole institutional structure of economic life associated with competition and the individualistic spirit of bygone days.[41] This orientation of thought brings with it new problems.

[39] See p. 172.

[40] See H. Mullensiefen and W. Dorinkel, *Das neue Kartell-Zwangskartell- und Preisüberwachungsrecht*, 1933, p. 9.

[41] An interesting sidelight on this ideology is seen in connection with the internal government of cartels. The observance of democratic rules in electing

With regard to cartelization, nationalistic authoritative state policy is faced with three difficult problems: how to define, apart from the interests of certain groups, the interests of "national economy" and "common weal"; how to devise a consistent theory for delimiting the competitive sphere from its monopolistic counterpart; and what actual innovations of organization and control to introduce which are consistent with the profit system. The period during which this policy has been in operation has been so short, and the influence of depressed trade conditions so imperative during that period, that any attempt to arrive at an insight into the exact objectives and effects of this policy would be premature at the present state of development.

THE MAIN PROBLEMS OF STATE POLICY

In the analysis which follows, the problems discussed will be primarily those which are at issue where the organizing policy toward cartelization is followed.[42] As was emphasized in the course of the earlier analysis, organizing state policy is deeply influenced by the considerations fundamental to the development of cartelization, that is to say, those related to the existence of industrial over-capacity in restricted markets. This as-

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the officers and in making important decisions is, of course, institutional with cartels. Since democratic procedure is inconsistent with the ideas proclaimed by the National-Socialist movement, the question how far the principle of "leadership" may be made effective for cartels is being discussed in Germany. (See *Deutscher Volkswirt*, 1934, Vol. VIII, p. 723.) But up to the present no adequate solution of this difficult question seems to have been arrived at.

[42] This narrowing of the scope of the discussion has been decided upon for two reasons: (1) in American experience the atomistic policy has been predominant and has been based on grounds which have had thoroughgoing public discussion; (2) as stated earlier, experience is very limited concerning policies pursued under the totalitarian state, and consists mainly in an accentuation of tendencies which are most clearly seen under organizing policy.

pect of the economic environment essentially differs from the conception of economic order which underlies atomistic policy based on the principle of free competition.

On closer examination it becomes apparent that organizing policy is hardly less opposed than is its atomistic antitype to monopolistic exploitation of expanding markets. It is not, in other words, designed to provide opportunities for the private monopolistic exploitation of favorable market situations. But the forms of monopolistic organization do not appear and disappear in response to changing market conditions. If their legitimacy is recognized and their development fostered under depressed conditions, the maintenance of monopolistic control through all phases of changing market conditions can hardly be disallowed. Thus, irrespective of market conditions, an economic philosophy derived from insight into depression phenomena is basic to the general attitude towards the consequences of promoting, or at least tolerating, the development of combinations in restraint of trade.

The never-ending range of debates on the principles of such policy and the measures to be adopted under it, the amazing number of fruitless or unsatisfactory legislative attempts to arrive at a consistent regimentation of cartelization, tell the story of the difficult, and probably insoluble, problems raised by this relentlessly developing movement. These problems are mainly due to the chameleon-like nature of monopolies, which may vary as to the form they take, as to their degree and importance, as to the manner in which their powers are exercised, and as to the effects they may have under the influences of changing business conditions. Moreover, such effects can, at best, be traced within a narrow eco-

nomic field directly affected by monopolistic operations. All efforts toward the collection of reliable evidence, which would permit of establishing the more remote but perhaps even more important effects, are as a rule unavailing.

It is evident that the problems involved here are very comprehensive in scope since the fundamental question, "monopoly versus free competition," including all its intricate ramifications, is at issue. Monopolies are not exclusively created, maintained, and operated by cartels, but equally by other forms of combinations, even by single large-scale concerns. Therefore, state interference with monopolistic market control, if deemed advisable, ought to be concerned with all forms of monopoly, and not limited to cartels. This inference was drawn by the Norwegian law and by the German cartel decree which, as indicated by its title, is directed against any misuse of economic—that is to say, monopolistic—power, though it was applied in practice exclusively to cartels.

This German decree clearly points to the primary objectives of organizing policy. Monopolies as such are not the object of state intervention; their establishment, by concerted action or otherwise, is recognized as unavoidable, even as advantageous. But misuse of powerful monopolistic positions is to be prevented. How is such misuse adequately to be defined and clearly to be delimited from lawful monopolistic practices? Many puzzling issues are involved in this apparently simple question.

In the debates turning on this question, and equally by German legislation, a distinction is drawn between violation of private interests and the interests of "common weal" or "national economy." This is an entirely

proper distinction. It is true, of course, in an economic system essentially based on private ownership of productive equipment, that prejudice to the public interest may in certain connections mean widespread damage to private interests by privileged groups. But the matter goes deeper than that. It is evident that the existence of powerful combinations, controlling considerable portions of a nation's productive capacity and extending their influence throughout the whole economic structure, may involve dangers for the social fabric of the country which are not reducible to the terms of mere economic damage to private individuals. They may introduce developments antipathetic to the traditions of a country or inimical to the conditions upon which its political stability is based.

Atomistic policy, as adopted by the United States, was largely influenced by considerations of this kind; and it is hardly necessary to stress the fact that antitrust legislation and, even to a higher degree, its enforcement were moved by the fear lest the foundations of democracy might be shattered by the economic and financial power of large combinations.

But organizing policy under which, on principle, free course is given to the development of the combination movement, though faced with the problem, has never developed any doctrine upon which to base a rational policy of discriminatory treatment of different manifestations of private monopolistic power. Nor—what is even more serious—has it developed any consistent theory of monopoly.[43] Thus, interpretation of the monopoly concept has sometimes gone so far as to deny the "mo-

[43] Some problems involved here are ably discussed, from the point of view of German cartel legislation, by A. Wolfers, *Das Kartellproblem*, pp. 125 ff. See also I. Dobretsberger, *Konkurrenz und Monopol*, 1929, p. 62.

nopolistic" character of regulation of production and price-fixing, if such measures are taken in periods of falling prices and do not permit reaping of exaggerated profits. Administrative or judicial proceedings are not directed against measures adopted in general by cartel policy, but exclusively against cases in which the effects of such measures are considered prejudicial to important private interests of individuals or to certain groups of consumers. If, however, a court—a common law court or a special cartel court—is asked to pay heed to "public interest" in making its decisions, it lacks a guiding principle, which can only be derived from a clear insight into the relationship between monopolistic market control and the operating processes of the existing economic system. Public interest as actually conceived by German judicial interpretation means nothing else than that allowance is made for the private interests of third parties or groups not directly concerned in the issue.[44]

Under such circumstances the notion of "abuse of economic power," if strictly interpreted, is likely to be applicable to a very limited range of cases. And that is what, in effect, happened in Germany and elsewhere. In the report on the legal aspects of industrial agreements prepared by three legal experts for the Economic Committee of the League of Nations this fact is clearly brought out:

> As a matter of fact, the judicial suppression of the abuse of power by cartels, in the field both of criminal and of civil or commercial law, has not assumed a uniform character in all countries. Its practical influence has, moreover, been very

[44] This point was especially discussed at the 35th meeting of German jurists mentioned above; it is brought out with important arguments by F. Schreier, "Aufgaben der Kartelljurisprudenz," *Schriften des Vereins für Sozialpolitik*, Vol. 180, Pt. I, p. 79.

slight. . . . The limits of public order vary according to the opinion of the part played by the cartel in economic life of the country held at the moment the decision is given by each tribunal before which any particular case is brought. These limits also vary according to the importance each court attaches to the maintenance of free competition as an instrument of progress. The view taken by common law courts often differs widely from that taken by the general public and by the officials entrusted with the supervision of industrial and commercial matters and the defence of general interests.[45]

The clash between divergent opinions alluded to in the last passage of the quotation is easy to understand. While the general legal system, as it is still in force in many industrial countries, is based on the economic and social philosophy of free competition, the economic system has undergone gradual but far-reaching changes in the direction of establishing large monopolistic domains imbedded, so to speak, within the competitive area. Thus "public interest," formerly identified with the outcome of the competitive process, is bound to be interpreted in a different way. Use of economic (monopolistic) power as such is now held consistent with public interest; and the antithesis relevant to judicial decision is no longer stated as "free competition versus monopoly," but as "good" cartels (and trusts) versus "bad" ones. The damage to public interest by misuse of economic power is quite generally assumed when clearly definable private interests are seriously prejudiced by extortion of excessive prices or excessive terms of contract or by excessive coercion. Definition of what is held to be "excessive" may vary both as between different national systems of jurisdiction, and as between different administrative and judicial officials. Since the mo-

[45] *Review of the Legal Aspects of Industrial Agreements*, p. 11.

nopolistic powers exercised by large corporate combinations do not, as a rule, contravene the concept of public interest as interpreted in the majority of countries, judicial interference with their monopolistic activities has —outside the United States and several British colonies —hardly ever been attempted.

There is no need to discuss here at length cases of "misuse of economic power" in which coercion by cartels is exacted against reluctant members forced to comply with the agreement in spite of being prejudiced by the policy of the cartel; or boycotting practices used in combating outsiders; or oppressive tying contracts and exclusive trade agreements imposed on customers. Such and kindred coercive operations may be conceived, on closer examination, as varieties of "unfair competition," qualified by the circumstances under which liberty of trading is impaired. It is evident that economic power as defined here is not equivalent to monopolistic power strictly speaking. This is clearly shown by the history of the German "cartel decree" which owed its existence to the attacks of public opinion on the practices of selling-terms associations which did not even contemplate regulation of production.

What matters in this connection is the fact that, under organizing state policy, the borderline between licit and illicit coercion cannot be defined with any degree of precision. If restraint of trade is, on principle, lawful and even desirable; if cartels are to be left free in pursuing their objectives by concerted action; then a high degree of economic coercion is equally to be considered as lawful. The right of cartel members to cancel the agreement without due notice must be limited to exceptional cases; otherwise cartel discipline may be seriously impaired and the very existence of cartelization

endangered. Likewise, coercion exerted against competitive outsiders is, as a rule, indispensable for securing monopolistic control over a market and must therefore be permitted in the majority of cases.[46] The same is true of exclusive trading agreements, which are to be reckoned among the most efficient means of combating outside competition. The distinctions between what is licit and illicit, if made from the point of view of cartel philosophy, entirely differ from rules based upon a belief in the merits of economic freedom. Organizing state policy is bound to comply in principle with this cartel philosophy.

This involves the setting up of a new code of trade morals derived from cartel consciousness. By virtue of this code, under the leadership of cartel agencies, coercive actions are without hesitation performed which would be held inconsistent with business morals if committed by single concerns for their individual benefit. Combinations are granted the right of private execution against those interfering with their interests.[47] The greater the need of securing monopolistic power, the greater, as a rule, is the tendency towards adopting coercive measures. Freedom of contract was made fundamental to the legal systems under the rule of free

[46] The difficulties involved in deciding cases of this kind may be illustrated by the reasoning of H. v. Beckerath, *Modern Industrial Organization*, 1933, p. 278. He strongly condemns "industrial piracy" (combination of a group of manufacturers for the economic suppression of their colleagues by depriving them of raw material sources, customers, etc.) which would violate a fundamental condition of the current economic system, namely, the guaranty of legitimate private property. But he goes on to argue that cartels cannot forego the right to prevent the rise of outsiders under the shelter of the cartel prices. "If one considers such cartel activity desirable in the interest of avoiding a waste of capital, irregular employment and violent price fluctuations, one must also second the external means of cartel enforcement for the suppression of outside competition, in many cases a means whose use is necessary for preventing over-production."

[47] See F. Kestner and O. Lehnich, *Der Organisationszwang*, 1927, pp. 178 ff.

competition. But if voluntary agreements with a view of establishing monopolies are rendered lawful, some sort of coercion is bound to ensue.

Coercion, considered as a means of creating or maintaining monopolistic positions, is auxiliary to the main objectives of cartel policy, which consist in regulating production and prices. Since regulation of production is a matter of internal arrangement between the cartel members, as a rule it is not interfered with by state policy. The main interest of the latter centers on price-fixing practices which affect economic life in a directly observable way. The comprehensive machinery set up by the Norwegian law is an attempt to introduce a thoroughgoing administrative control of monopolized prices. On the other hand, the clauses of the German decree which provided for interference with price-fixing (Sections 4 and 10) were hardly ever applied in practice.

In practice, whenever the exercise of monopolistic power as such is considered lawful, the administrative or judicial authority asked to pass judgment upon the propriety of a monopolized price is faced with a very difficult task. It is debarred from regarding a price as excessive because it differs from the price which might have obtained under free competition. Even if the latter could ever be determined with any degree of accuracy, it is irrelevant as a criterion, since the very purpose of a cartel is to cause prices to be different from what they would be under competition, and especially so under circumstances which would require marginal producers to sell below cost. For obvious reasons also the "general level of prices" is unsuitable as a standard, apart from the intricacies its use would involve.

French court decisions and legislation have unreserv-

edly resorted to the expedient of making excessive profits the gauge for determining offenses. This rule seems to be derived from the aspects of expanding or at least largely stationary markets which might permit the monopolist ruthlessly to exploit consumers. But it is of no avail in judging cartel policy, especially in periods of depressed markets, when prices are maintained in more or less close correspondence to the costs of the marginal producers. Cartel policy is most actively concerned with price control in the very periods in which the prospects of profits are poorest. And, in any case, the meaning of "excessive profit" may become very doubtful if applied to the members of a collective monopoly producing at highly divergent costs.

Finally, there exists a vague standard which can be adopted in judging the propriety of monopolistic price-fixing: the damage inflicted upon the consumers. But in the majority of cases all that can be determined in this respect is the fact of some prejudice to immediate purchasers, unmeasurable as to amount. Nor would this immediate burden, even if measurable, indicate the character of the economic effects, since purchasers are very often in a position to shift the incidence of price increases to other shoulders. The ultimate effects of price-fixing are therefore veiled by impenetrable processes of adjustment of prices, wages, and incomes.

It follows from these and kindred considerations that in countries in which cartelization is accepted in principle and is far advanced, the standard of what is to be considered as lawful price-fixing will be set up by common cartel practice. Here, as in the case of coercive restraint of trade, official policy will be taken in tow by cartel philosophy if each case is separately considered

on its merits by a judicial body,[48] and if institution of proceedings is made dependent upon private action. This course was deliberately taken by the authors of the German cartel decree by securing unofficial arbitration boards precedence before the cartel court and by granting the cartelized trades adequate representation on the bench.

It is easy to understand that those who are generally apprehensive of the adverse effects which far-reaching cartelization might have on economic life insist upon the creation of an administrative machinery charged with the task of continuous supervision of cartel activities and vested with the power of investigation and interference, quite apart from the question whether or not private proceedings are taken. Opinions differ as to whether compulsory registration of all cartels is to be prescribed (as by the Norwegian law) or whether the facts relevant to the purposes of control are so rapidly changing that registration might amount to an expensive collection of useless materials. Other divergences of opinion relate to the question whether a special cartel board or office is to be created (as in Norway) or whether an existing department (in Germany, the Ministry of Economy) is to be charged with the supervisory functions. (To the latter effect are the proposals of the Czechoslovakian bill and the resolutions adopted by the German jurists.)

In England the institution of "machinery for the investigation of the operation of monopolies, trusts and combines" was suggested by the *Report of the Committee*

[48] The question so eagerly discussed by German jurists whether a special cartel court or the ordinary court should be competent in deciding cartel issues is of secondary importance.

on Trusts.[49] The example set by the commissions and other tribunals created for that purpose in the United States and the British colonies was expressly referred to. It was proposed that the Board of Trade be charged with the task of collecting current information concerning the operations of monopolistic combinations or agreements, and of referring to a special tribunal for investigation and report cases in which the public interest might be adversely affected. The tribunal was to be composed in a way securing the participation of representative trade organizations, including the co-operative movement and trade unions. Finally, it was found desirable to entrust the Board of Trade with the additional task of making recommendations as to state action for the "remedying of any grievances which the tribunal may find to be established."

There exists, in all industrial countries with strong cartelization movements, an outspoken tendency towards setting up some administrative agency intended to assume general control over monopoly operations. For it has become evident that even "normal" use of monopolistic power may be prejudicial to public interest if extended over a large field of economic activity. Such a situation cannot be remedied by judicial proceedings, which do not lend themselves to the continuous control of dynamic processes, but only by delegating great discretionary power to administrative officials. No adequate machinery has, however, been devised in any country to cope with the amazingly complex problems which are involved.

A striking instance in point is supplied by the history of German emergency legislation in 1931. When adjustment of costs to prices was held to be seriously impaired

[49] Pp. 10–11. See also p. 270.

by the existence of a rigid block of cartelized prices, by virtue of special authorization a general 10 per cent reduction of all fixed prices (together with a similar reduction of wage rates established by collective agreements) was decreed by the government and carried through. But within the framework of principles and methods set up by organizing state policy—as contrasted with the authoritative one—more trenchant and discriminating measures of control over cartel regulation of production and sales were hardly ever conceived. Also, the proposal stressed by many economists to use tariff reductions as a means of setting limits to cartel policy has never received official consideration.[50]

Reluctance to resort to this device is easy to understand. To render it applicable, a far greater flexibility of tariff provisions would be required than is consistent with the tariff systems in force in most countries. But quite apart from this difficulty, such a measure might be contrary to the general economic policy of countries which look upon cartels as important weapons in the competitive struggle waging on international markets.[51]

The problems involved in the line of approach taken by organizing state policy are rendered even more intricate when compulsory cartelization is resorted to.

[50] Only under the rule of atomistic state policy has such a step been taken. In Canada, by virtue of the Combines Investigation Act, 1923, the Governor in Council is empowered to direct either that an article be admitted free of duty or that the duty thereon be reduced if, upon due investigation, it appears that "there exists any combine to promote unduly the advantage of manufacturers or dealers at the expense of the public, and that such disadvantage to the public is facilitated by custom duties imposed on the article."

"Judicious use of customs tariffs" is recommended by the League of Nations experts as the most adequate means of state policy in exercising its functions of guardian of the public interest. (See *International Industrial Agreements*, p. 34.)

[51] See p. 140.

Compulsory cartelization of this type is to be regarded as an emergency measure, essentially deflationary in character, since increase of prices and safeguarding of profits are to be secured by restriction of production, apart from and, as the case may be, even contradictory to any measures taken with a view to expanding purchasing power and increasing effective demand in markets. The concept of partial and limited equilibrium ruling the industries concerned, each considered as a separate unit, is obviously made basic to this line of policy, and the question how to restore the general economic equilibrium is hardly raised in this connection. Hence this policy takes its consistent place in a system of policy which includes the assessment of import quotas, international barter agreements, reduction of agricultural production, valorization schemes, and the like.

It is evident that the issues which are at stake when a judgment is to be passed on the lawfulness of measures taken by voluntary cartels will make their reappearance with largely enhanced intricacy when enforcement of cartelization on a given industry is decided upon. Above all, a preliminary question will have to be solved: Are the general conditions of the industry such as to justify the introduction of compulsory restraint of supply and, eventually, compensating increases in the prices of the cartelized products? The answer to be given to this question is likely to be based primarily upon some investigation into the actual conditions of the industry. But how is a judgment to be arrived at on the merits of the proposed agreement which is to be forced upon the reluctant members of the trade, and on the merits of the measures proposed with a view to regulating production and prices? This judgment has to be derived from some evaluation of the future trend of

business conditions. It becomes more delicate as the flexibility attaching to strictly voluntary agreements is superseded, under enforced cartels, by the rigidity of authoritatively approved contracts which cannot be modified apart from official sanction. In the debates of the French Chamber turning on the introduction of compulsory cartelizations the question was raised by various speakers whether an industry once brought under the rule of compulsory restraint could be expected ever to regain competitive freedom, considering the far-reaching changes of its structure which might be brought about by regulative measures. But it is interesting to note that in these debates no attempt was made clearly to advise the government as to the principles to be followed in embarking on this policy. If any such principles are to be set up this is left to the functioning of the administrative machinery and to the suggestions emanating from those business quarters mainly interested in controlling competition. The responsibility of the government is limited to the approval or disapproval of the compulsory agreements proposed, and to the surveillance of compliance by the trade organizations with the provisions of the approved contracts. In effect, the difficult and important problem of supervising the exercise of monopolistic powers is solved by avoidance.

It is, however, a question deserving serious attention, whether development of strong monopolistic powers within the economic structure will not force state authority sooner or later to assume far-reaching control over economic activity. Withdrawal of government from continuous and pervasive interference with economic action was based on the assumption that free working of competitive forces would secure the highest degree of

productive effects. Are satisfactory productive results to be expected when the price mechanism is seriously impeded in fulfilling its regulatory functions by a system of "bound" prices? If before the war the weight of cartelized prices was easily carried in countries where cartelization had assumed considerable proportions, this was due to the fact that depression periods were short in duration and quickly overcome. In prosperity periods cartels are likely to be rather inoffensive.

Thus, not only the destiny of the entire economic structure but also the ultimate relation of government to economic activity are likely to be determined by the course of cyclical fluctuations. Heavy and prolonged depressions are instrumental in fostering the tendencies militating against free competition by creating cartels and kindred combinations. But price-fixing and restriction of production, if extended over a large range of important commodities, can hardly be left, in depression periods, to the discretion of those interested in adjusting prices to their private benefit, but stand in need of some sort of control which can only be exercised by a public authority. Cartelization, even though originating from free agreements and developing on principle apart from any state interference, may very well result in saddling the state with a heavy burden of responsibility for the functioning of the economic system in all its complex relations, as was the case in all previous periods of history in which monopolies were basic to the system of production.

CHAPTER VII

CODES AND CARTELS[1]

In the preceding chapters an attempt has been made (1) to state the characteristics differentiating cartels from other forms of combination; (2) to examine the economic circumstances which are conducive to the spread of cartelization; (3) to outline the controlling policies of cartels; (4) to analyze certain economic effects of cartels; and finally, to exhibit the changing phases of national policies toward cartelization. This has been done without any effort to draw analogies to American experience.

American economic history shows the impact of the movement towards industrial combination, but mainly in the form of large corporate combinations. For more than a generation cartel-like combinations have been outlawed by federal law, and even earlier were suspect under the common law rules of the several states. Such cartel-like organizations as have existed have been illegal and secret. There have probably not been many of any importance, since the popular modes of breaking the anti-trust laws have been the more ephemeral and less restricting forms of mere price-fixing.

To what extent the absence of cartels is due to their unlawfulness there is no way of determining. That is to say, no one can say with confidence whether, in the absence of restricting laws, cartelization would have become an important element in the American economic structure, though there is no doubt that it would have

[1] In the author's study of the NRA, upon which this chapter is based, he was greatly benefited by his close association with the authors of *The National Recovery Administration*, The Brookings Institution, 1935.

made some headway. What can be said is that even in industrial circles no strong sentiment has until quite recently existed for legalizing combinations of the cartel type. The agitation for relaxing the anti-trust laws has seldom gone beyond the desire to legalize price agreements.

A good many reasons might be adduced in explanation of that fact: the popular support which the anti-trust laws enjoyed; the relatively effective state of "leadership" maintained by the larger corporate groups; the lack of faith on the part of industrialists that American industries could be voluntarily regimented; and so on. Whatever the degree to which monopolistic elements have entered the American economy, the frank recognition of the right of monopoly to exist and to exercise the coercion necessary to its existence has been thoroughly opposed to the American tradition.

Underlying the continuance of this individualistic tradition there has been an optimistic outlook upon the prospects of market expansion. This outlook has been well founded in the circumstances of American economic life; and no temporary run of adverse business circumstances has ever been able to undermine it effectively as the foundation of economic policy—never, that is, until during the present prolonged depression new policies were applied to the control of both agriculture and industry.

THE APPEARANCE OF CARTELIZING TENDENCIES

That the depression had created a strong drift of opinion toward finding merit in collective industrial action was dramatically illustrated by developments under the National Recovery Administration. Though the "codes of fair competition" have disappeared by Su-

preme Court fiat, some purpose may be served by considering whether they show a family relationship to cartels. To what extent are the modifications of the American industrial structure which the codes envisaged to be considered akin to cartelization as known to European experience? The purpose of such an inquiry is not morbid concern for the dead body of codes, but to illuminate types of business response to economic circumstances of a sort that might well be fraught with future consequence.

In order to clear the ground for an examination of this question it may be helpful to point out in a few sentences the salient features of cartelization. They can be summarized briefly as follows:

1. Since cartels originate from the outlook on depressed markets, their primary objective is to prevent prices from falling below the cost of production of the less efficient concerns. Such an adaptation of prices to costs is the ultimate purpose of any cartel policy. We may refer to this as the "cost principle."

2. With this end in view the market of a given industry is regarded as an entity to be protected against outside competition. This may be called the "collective market principle."

3. Competition between the members of the industry is restricted in ways to diminish competitive risks by ensuring each member a place in the market and by passing a part of the burden of risk-bearing to other groups through price control. This may be called the "collective risk principle."

4. The maintenance of the cost-price relation is secured by the creation of a collective monopoly, resulting in various schemes suitable for adapting the output or the sales of the industry to such a demand as can be met

at satisfactory prices. The monopoly providing for the protection of the vested interests of the cartel members is protected against attacks on the part of outside competitors. This may be called the "collective monopoly principle."

Any other features of cartel activity and cartel policy can be shown to be subordinate to these four general principles. Are these principles equally characteristic of controlled competition as brought about by the code-making process?

Primary Objectives of the Recovery Act

In approaching the collective forms of action undertaken under the National Recovery Administration, it is necessary to make a clear distinction between certain ideas which were instrumental to its creation and the tendencies which came to play a dominant role in its operations.

Two of the primary purposes underlying the National Industrial Recovery Act were to increase the spending power of large masses of wage earners and to spread employment over as many unemployed as possible. Hence the establishment of minimum wages and the shortening of periods of labor were made the cornerstones of the industrial recovery plan. Whatever judgment one may have upon the so-called "purchasing power" theory underlying this line of economic action, there can be no doubt that this theory bears no relation to the general principles characteristic of cartelization. Apart from work-spreading for relief purposes, the presumption of beneficial effect of wage increases is based on the inference that the rate of industrial production can be speeded up by diverting more of accruing national income to the wage-earning group. Whether or not this inference is justified need not be gone into

here. It is sufficient to note that the end in view is entirely alien to control and division of the market.

Wage control also was thought of as a means of ending a "downward spiral of wages and prices" which was considered inimical to the making of forward business commitments. The attainment of relative stability of wage costs, and correlatively of prices, was thought of as a necessary forerunner of business expansion. Though cartels have never failed to work towards stabilization of prices, they have never approached the price problem through the medium of wage control.

With these and the various social reform objectives of the Recovery Act we have no concern here. It is, however, of importance to note for the purpose at hand that the Recovery Act, though engendered by the circumstances of abnormal market contraction, was not primarily motivated, as is the case with cartel policy, by the idea of adapting output and prices to given restricted markets, but by the rather opposite idea of spreading purchasing power with the object of expanding the markets of consumer goods. While cartel policy takes its start from the side of prices which are to be adjusted to the costs of production, the industrial recovery program did not recoil from enhancing costs of production. Employers were presented with what amounted to a moral challenge to put the program into effect by combined action and "industrial self-government"; with the proviso,[2] however, that in order to give the plan full effect during the first critical months and even at the ex-

[2] By the President's Re-employment Agreement the so-called "blanket code," employers were bound "not to increase the price of any merchandise . . . by more than is made necessary by actual increases in production, replacement, and invoice costs of merchandise since July 1, 1933 or by taxes or other costs resulting from action taken pursuant to the Agricultural Adjustment Act, and in setting such price increases, to give full weight to probable increases in sales volume and to refrain from taking profiteering advantage of the consuming public."

pense of profits, price increases should be deferred as long as possible with a view to strengthening the purchasing power of wages. This proviso was obviously in opposition to any cartelization tendency.

Objectives of Business Groups

The significance of this avowed program was, however, greatly diminished by the views of the business groups which were called upon to promote it and by what the National Recovery Administration permitted to be written into codes. Business representatives who came to play an important part in establishing new rules and regulations for the future conduct of competing enterprises were largely influenced by some sort of "over-production" theory which in its consequences was likely to lead to the postulates underlying cartel policy. The idea of "profitless prosperity," so popular in business circles before the depression, was almost uniformly related to the concept of over-production or over-capacity. The idea of "destructive competition," which was the depression-time successor to "profitless prosperity," was traced to the same source.[3]

Under the purchasing power theory, "rationalizing" competition meant upholding the wage structure. In the business philosophy it meant upholding the profit structure. Both aspects, as combined by the New Deal philosophy, resulted in blaming outright free competition for the evils attaching to the present economic system. Rationalization of competition is precisely the ultimate objective of cartelization if by rationalization is under-

[3] In this connection it may be noted that the report of the committee on continuity of business and employment of the Chamber of Commerce of the United States regarded the adjustment of production to market demand as the central problem to be attacked.

stood securing of adequate profits. The acceptance of this idea implies the pursuit of lines of action which logically lead to cartelization.

Certain ideas which were widely accepted at the NRA had the air of being preparatory to cartelization. There was above all the idea that a new balance of the economic system is likely to be reached by regulating the conditions of each industry separately, more or less independently of others. Hence a general scheme was adopted intended to organize all undertakings by industries and to establish definite and lasting relations between concerns which were connected by their interest in the same or related markets. At the very beginning the concept of the "market" was left undefined. But on principle the atomistic structure of the present economic system was to be superseded by some sort of co-operative organization, and specific regulations were to be made binding upon all those undertakings belonging to the same sphere of trade.

Again, in harmony with general tendencies characteristic of the cartelization move, the decision how to determine the sphere of each trade was left on principle to the undertakings concerned and especially to associations which might be considered representative of their interests. Codes of fair competition applied to groups thus defined were to be administered by bodies representative of the groups.

The specific importance attached to the concept of "fair competition" by the recovery legislation was due to a widening out of this concept far beyond its customary meaning. The idea of securing fair competition by organized co-operation of competitive concerns was of course familiar to American industry. Struggle

against unfair trade practices had been an essential objective of many trade associations. But under the codes the meaning of the term was so far stretched as to embrace compliance not only with various provisions relevant to labor conditions, but also with regulations directly or indirectly connected with the control of prices and production. Putting a "bottom under prices" by other than wage provisions came to be considered by the majority of business representatives an indispensable part of the program.[4] Hence, quite generally, selling of products below cost was declared inconsistent with commendable trade practices, and it thus happened that in the course of the code-making process the first of the cartel principles mentioned above (page 203) secured a fundamental significance for the new structure of American industry.

The Juridical Problem

The Recovery Administration was then faced with the difficult question of how to apply the cost principle without acknowledging the validity of the other principles characteristic of cartelization. This question was very similar to those eagerly discussed for decades in European countries in which the principles of free competition had been undermined, under the pressure of

[4] A widespread business viewpoint is expressed in an address by Charles R. Stevenson, "Price Control and Allotment of Business," delivered at Cleveland before the National Association of Cost Accountants, June 26, 1934, as follows:

"Industry undertook to meet the wishes of the Administration in regard to reduced hours and higher wages, and, in return for this concession, industry was promised the right to enter into enforceable agreements which would bring about stability of price and profitable operation. In other words, both the Administration and industry recognized that the time-honored principle of unrestricted competition had broken down and that during the emergency period, at any rate, a system of controlled competition would have to be tried."

contracting markets, by the development of strong monopolistic tendencies. Since the anti-trust legislation had done more than had been done anywhere else to combat these tendencies, it was very difficult to draw a sharp borderline between what now might be considered lawful limitation of competition and unlawful restraint of trade in the much narrower sense attached to this notion by the new official economic philosophy.

The question was confused by the fact that, though business action permitted under the provisions of codes was relieved from the penalties of the anti-trust laws, it was expressly stated in the act that "codes shall not permit monopolies or monopolistic practices." The inconsistency involved in the blunt juxtaposition of two opposite legislative principles was too apparent to permit an easy, uncontroverted juridical construction. The juridical problem was that of separating forms of collective market control which were "monopolistic" from those which were not; that is, of deciding when a monopolistic practice is not a monopolistic practice in a legal sense. The Supreme Court had gone a good way toward modifying the idea of illegal restraint of trade in the Appalachian Coal decision (1932), whereby a large number of mines were permitted to operate a common selling agency. This somewhat resembled "the process of reason" by which European courts had earlier dethroned the sway of free competition. But it was on the whole irrelevant to the NRA problem, since it was predicated on the existence of independent competition, and in any case defined what could be done *inside*, not *outside*, the anti-trust laws.

The NRA itself was not too much disturbed by this juridical problem. Its view of its scope of action seems to have been that which is implied in President Roose-

velt's statement that "the anti-trust laws still stand firmly against monopolies that restrain trade and price-fixing which allows *inordinate* profits or *unfairly* high prices."[5] Collective modes of action authorized by the President, the results of which fell within the bounds of "fairness" or "reasonableness," were removed from the connotations of the term "monopolistic." By this somewhat indeterminate interpretation the scope for collective action was rather wide.

On close examination it becomes evident that in defining the characteristics of collective action which were to remain subject to the provisions of the anti-trust laws, the NRA economic philosophy resorted to concepts which are primarily applicable under circumstances of expanding markets and rising prices. Under such conditions "exaggerated profits" or "unfairly high prices" are likely to supply at least plausible standards for judging the degree of monopolistic exploitation.[6] Under depressed business conditions, however, such standards may prove wholly inappropriate, the more so as the concepts of "fair" profits and "justifiable" prices are based on the problematic idea of "legitimate" costs.

Pre-NRA Price Control

The idea of deriving standards of fair competition from the strict observance of the cost principle, revolutionary as it was for American legislation, was very familiar to the economic reasoning of large groups of American business men. Acknowledgment of this principle as a means of eliminating "cut-throat" competition and of maintaining "fair" prices had figured for

[5] From the President's statement of June 16, 1933 outlining the policies of the National Recovery Administration. Quoted from *NRA Bulletin No. 1.* Italics supplied.

[6] See p. 194.

many years among the postulates stressed by the trade association movement. Many trade associations had endeavored to promote the adoption by their members of accurate or of uniform cost accounting methods which, if made basic to the determination of prices, were likely to prevent selling below cost. Even the establishment of uniform figures of cost, though held illegal under the anti-trust legislation, had in some cases been secretly resorted to.[7]

Another method of securing the observance of minimum prices had been adopted by the "open-price associations" which maintained a common agency through which the members exchanged information as to prices on past transactions and other data. With a limited number of competitors and a few large concerns leading in the industry this procedure could easily be transformed, by way of explicit or tacit understandings, into the establishment of regular lists of price quotations meant to remain in force for a more or less definite period to come. Price collusion in other forms existed. Moreover, as pointed out in the report of the Columbia University Commission,

> . . . the trust problem has, in fact, reappeared in a new guise. Firms often without monopolistic positions in the strict sense, but forced by the large proportion of the market they command to take account of their power to affect the market price both directly and through the reaction of rivals to their own policy, have been forced into conduct partly monopolistic.[8]

The practice of collective price control has at times been openly admitted by business men.[9] The existence

[7] See S. N. Whitney, *Trade Associations and Industrial Control*, p. 43.

[8] *Economic Reconstruction*, 1934, p. 15.

[9] See, for example, Charles R. Stevenson, *Price Control and Allotment of Business*, p. 7. "Practically, under the Harding, Coolidge, and Hoover ad-

of "administered" prices is strongly to be inferred from price data covering nearly eight years assembled by the Research and Planning Division of the NRA.[10] A considerable group of prices, especially in industries producing building materials and other capital equipment, showed very infrequent changes. Price rigidity of this kind observed for a period marked by heavy and incessant price fluctuations in other fields points to a stabilizing influence of some sort; and one is justified in tracing it, in part, to the operation of trade associations or kindred organizations which were in a position to control their markets.

Owing to the inherent weakness of price-fixing methods not backed by strict regulation of output and sales, however, the influence exerted by the trade association movement on the American price structure was no doubt relatively much less than the corresponding effects of cartelization in some European countries. Moreover, there is no doubt that under the pressure of the slump in business the majority of trade associations lost much of their previous cohesion and strength.[11] Renewed agitation after 1930 for revision or repeal of anti-trust legislation may be taken as indicative of the urgent desire of business representatives to establish a more efficient basis for co-operative action in industry.

The Market Principle of Industrial Grouping

At the very beginning of the code-making process there was a tendency to adopt uniform labor provisions

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ministrations industry enjoyed, to all intents and purposes, a moratorium from the Sherman Act, and, through the more or less effective trade associations which were developed in most of our industries, competition was, to a very considerable extent, controlled."

[10] *Prices and Price Provisions in Codes*, NRA, January 1935.

[11] See E. L. Heernance, *Can Business Govern Itself?* 1933, p. 105.

for large constituencies. This was hardly consistent with cartelization tendencies. Experience goes to show that cartels were never meant to create employers' organizations suitable for settling conditions of labor. Provisions relevant to wages or hours of work have hardly ever been made constituent parts of cartel agreements. Special employers' organizations separate from cartels have been charged with the task of settling and enforcing regulations of this type whenever they were made the object of contractual agreements.

There existed therefore in the code-making process a clash between two divergent principles of industrial organization: the tendency on the part of the Administration to stress the adoption of labor conditions uniform for large fields of industrial activity met with the rival tendency of business representatives to organize the industries strictly on market lines with a view to placing limitations upon free competition. After a first preliminary period the latter tendency gained the upper hand and the definition of industries on market lines became a characteristic feature of the new industrial set-up. This development, resulting in a considerable number of codes, corresponds exactly to the grouping characteristic of cartels. It also, of course, corresponds to the earlier grouping of American trade associations. What is important in this connection is that the fundamental groupings under the NRA were those appropriate to market control rather than those appropriate for regulation of labor conditions; and the basic incentives were those of market control. An important consequence is seen in the fact that 560 out of 677 codes made provision for price protection through cost accounting methods or otherwise.[12]

[12] From *Prices and Price Provisions in Codes.*

It is a striking fact that even the representatives of labor interests did not protest against the splitting up of large areas of industry into code groups intended to include exclusively competitive undertakings. They appear to have operated on the principle that there was a chance of obtaining, for the hands employed by these concerns, somewhat better conditions than were likely to be conceded by extending the codes' constituencies. The same convergence of interests between cartelized employers and their employees which is noticeable throughout the whole cartelization movement[13] made its appearance also in the American experiment of code-making.

Even where the grouping of industries was influenced by considerations relevant to labor conditions, common interests in given markets found ample recognition in the creation of product subdivisions and regional subdivisions under many codes. The process of splitting up the administrative machinery in order to adapt it more closely to the purpose of controlling competitive activity offers a striking evidence of the ultimate tendencies which came to be fostered by the recovery legislation. Not to mention other points of similarity, the regional organizations set up under most of the codes covering mining and quarrying operations bear a striking resemblance to some characteristic features of cartelization in other countries, chiefly in Germany. The same is true of subdivisions set up for other industries the products of which are highly standardized and are sold only in regional markets by reason of considerable transportation costs (clay products, cement, lime, and the like).[14]

[13] See p. 134.

[14] See Leverett S. Lyon and others, *The National Recovery Administration*, 1935, Chs. VI and VII.

The wide existence of sentiment favoring developments in the direction of cartelization is illustrated by a referendum vote taken at the end of 1934 by the United States Chamber of Commerce and intended to get the views of the affiliated organizations on the future destiny of the recovery legislation.[15] An overwhelming majority of the votes cast was in favor of the proposal

> . . . that each industry should be permitted to formulate and to put into effect rules of fair competition which receive governmental approval, but that the governmental agency should have only the power of approval or veto.

Equally welcome was another proposal to the effect that:

> Rules of fair competition formulated by a clearly preponderant part of an industry as suitable for the whole industry with due consideration for small units and approved by the governmental agency should be enforceable against all concerns in the industry.

Moreover not less than about 90 per cent of the votes agreed to the proposition

> . . . that there should be opportunity for members of an industry to enter into agreements other than rules which when approved by the governmental agency will be enforceable against parties to the agreement.

Equally endorsed by an overwhelming majority was the proposal that the new legislation should make clear

> . . . that its provisions, so far as compliance with them is concerned, will supersede any other statute which might appear to conflict.

The statutes to which allusion is made here are undoubtedly the anti-trust laws.

The proposals quoted were obviously guided and

[15] *U. S. Chamber of Commerce Special Bulletin,* Jan. 10, 1935.

linked together by an economic policy meant to deliver self-government of industry from enforcement of regulations not desired by the industry. The objectives were to break up the industrial structure into industries defined on market lines, or even into groups of competitive concerns formed by voluntary agreements, and to authorize each industry or group under this scheme to regulate its competitive conditions independently of any other. The "share-the-work" postulate voiced by labor's representatives was paralleled by the "share-the-market" demand of organized employers. While under a system of free competition all undertakings are indistinctly connected with each other by the free movement of uncontrolled prices, the proposals appear to envisage the erecting of barriers of fixed prices from industry to industry and the shifting of commercial risk from each firmly entrenched industry to the preceding or successive stages of processing.

CARTEL-LIKE DEVELOPMENTS UNDER THE NRA

The monopolistic tendencies so strongly evidenced in the motives of industrial groups were permitted only a mild embodiment in the large majority of codes. General restrictions of free competition as commonly adopted—prohibition of destructive price-cutting, of selling below cost, of even provisions for minimum prices—were hardly more than preliminary steps on the way leading to outright cartelization. They were, however, steps in that direction, and deserve further attention. There were, moreover, some codes in which the steps were decidedly longer.

The Cost Principle and Price Control

A large majority of all codes provided one variant or another of the principle of "no selling below cost," usu-

ally in conjunction with a provision for uniform cost accounting. Apart from the merits of sound cost accounting methods for individual enterprises, the difficulties experienced in elaborating satisfactory methods to be applied to a whole industry are, as everybody knows, frequently insuperable.[16] Here code administration was faced with the same intricacies which seriously hampered the development of the German cost accounting associations.[17] The character of these difficulties led many groups to attempt to secure provisions which permitted arbitrary allocation of cost elements, thus approximating a system of price-fixing; and a number of such systems were approved by the NRA. But even where this was not the case, there was a very strong tendency to introduce such a system in practice, since the alternative was the breakdown of the cost protection scheme. The results of attempting cost protection therefore in some instances tended to be more monopolistic in character than could be seen in the letter of the code.

A further step in the direction of collective monopoly was taken by the inclusion in many codes of "open-price" schemes. It is easy to understand that such schemes are strongly favored by many representatives of business interests. In their earlier form, as permitted under judicial interpretation of the anti-trust laws, open-price plans involved reporting price information relating to past transactions only. Even so, they were transformed in some cases by explicit or tacit understandings into outright price-fixing agreements. Under the open-price plans in codes, current prices with terms and discounts applicable thereto were to be reported.

[16] See George Terborgh, *Price Control Devices in NRA Codes*, 1934; and Lyon and others, *The National Recovery Administration*, Chap. XXIII.

[17] See p. 31.

Strict observance of the prices, terms, and discounts as thus filed was made obligatory; and under most such systems, revised prices could be put into effect only after advance notification to the other members of the industry, the waiting periods typically ranging from five to fifteen days.

Such systems were not in formal character monopolistic and in practice were often entirely in harmony with active price competition. They did, however, facilitate the making of explicit or tacit price agreements, and permit coercion or persuasion to be used during the waiting period. They tended, even in the absence of such tactics, to make prices more rigid in some cases, since the incentive to reduce prices was reduced when no initial advantage in sales was to be gained thereby. Thus arrangements starting from individual price quotations were in some degree converted into what amounted to collectivistic non-competitive price schemes.

In numerous instances the codes went beyond the schemes of cost protection and price reporting mentioned above. A few of the earlier codes permitted minimum price-fixing and at least one outright price-fixing. A few of the cost formulas left so much to administrative discretion as to come to the same thing. And finally a large number of codes provided for the fixing of "emergency" minimum prices based on "lowest reasonable cost." Inclusion in codes of provisions relating to minimum price-fixing was, of course, not equivalent to their effective application. But the extensive recognition of the principle is of importance in the present connection.

Among the procedures closely related and complementary to the price-control provisions, transportation provisions included in many codes may be specially

mentioned. They were mostly meant to prevent price-cutting by granting freight allowances, free delivery, and the like. They varied in detail but their objectives were throughout the same: strict observance of clearly defined transportation charges as a constituent part of the cost accounting scheme basic to the determination of sales prices. The basing point provisions introduced into several codes had a more decidedly monopolistic flavor, tending to prevent effective price competition within the basing-point areas and to facilitate a kind of market control akin to regulations adopted elsewhere by cartels of the regional type.

In so far as codes were concerned with costs and minimum prices, they had rather marked resemblance to the so-called "price cartels" which in the earlier analysis it was thought proper to exclude from the strict cartel concept. The resemblance of such codes to cartels strictly defined is therefore not to be over-emphasized, and the purpose here is merely to indicate the similarities of tendency and purpose. A few points of comparison are, however, worthy of notice.

It is well demonstrated by the history of the combination movement that agreements relating to cost methods or minimum prices are as a rule rather loose in nature and easily broken off or discontinued under the pressure of changing market conditions. The codes attempted to evade this difficulty by making the provisions legally compulsory. In so doing they ran directly into the fact, so troublesome in cartel development, that the interests of all the members of an industry in any particular method of control are far from being identical. Effective market control is therefore predicated on the power to coerce, whether extra-legally or by the use of public

powers. But it is unlikely even then to be effective unless the will to act collectively is widely prevalent, so that only minor recalcitrant elements have to be coerced. The experience of the NRA with compliance, no less than the history of cartels, supports this observation.

The recognition of divergences of interest related to differences in size and financial backing was reflected by the provision of the Recovery Act designed to protect small enterprises against the adverse influence of large competitors in code-making and code administration. The presumption in code-making appears to have been that small competitors suffered most from unrestrained competition and would benefit from higher prices. This is undoubtedly true of some areas of trade. There are, on the other hand, areas in which small undertakings could maintain themselves only by prices which do not cover all items of overhead and by low wages. In such instances the two principles of protecting small enterprises and of cost protection were at cross-purposes.

From a purely juridical point of view, codes of fair competition may be considered akin to certain types of compulsory cartels created in Italy by recent legislation and based on proposals agreed upon by the majority of the members of a trade. Codes of fair competition were similarly proposals for market regulation submitted by representative trade organizations to a competent government agency, and were subject to modification and to enforcement on entire industries. In certain cases to be discussed later, in which regimentation of production and sales was provided for, the resemblance, extending even to the very nature of the regulatory devices, was indeed striking.

The parallelism between the American recovery legislation and European methods of industrial organization

is not to be over-stressed. Creation of outright collective monopolies lay in principle outside the American scheme, which was, moreover, conceived as an emergency measure and combined with an economic policy directed towards a general lifting of the price level. It should nevertheless be noted that the economic consequences were of a generally similar character, since they were those of market control for the maintenance of prices in weak markets.[18] The objections which can be raised against price control under the codes need not be gone into here since they are exactly analogous to those raised by cartel policy. The arguments in favor of such control are equally of an analogous sort.

On the whole, as was to be expected from the new system of controlled competition, the codes appear to have resulted in an increased degree of price rigidity, the economic effects of which were hardly in harmony with the ultimate objectives of the recovery program. So far as controlled competition meant control of prices, earlier experience gained from the entire history of cartelization was confirmed. From an analysis covering a large number of commodities—producer as well as consumer goods, produced partly under distress conditions, partly under sheltered conditions—an official inquiry drew the inference that "fluctuations in prices seem to be inversely related to fluctuations in production."[19] Comparisons made between prices and the volume of employment led to a similar observation:

[18] The process of price-fixing is obviously open to less objections when performed in a period of rising prices than when important lines of trade are spared, by price maintenance, the task of adjusting their costs to a falling price level. In any case, however, price-fixing in a period of restricted markets is likely to result in "congealing the capital values of the speculative era prior to the depression." See A. Sachs, "National Recovery Administration Policies," *America's Recovery Program*, Oxford University Press, 1934, p. 180.

[19] *Prices and Price Provisions in Codes*, Pt. VII.

Employment and man-hours have tended to increase most where prices have been most flexible. Note particularly that industries with the "worst price records" have the best employment records and the industries with prices of the 1929 level have afforded but little rise in employment. On the other hand, the baking, chemical, and boot and shoe industries show the greatest stability in employment while prices of their products average about 70 per cent of the 1929 level. On the other hand, the residential building, brick and tile, agricultural implements, and furniture industries give relatively much less employment, while the prices of their products average more than 90 per cent of the level in 1929.[20]

The official memorandum was no doubt right in warning against pushing this conclusion too far. But it insisted on the fact that "the charts indicate clearly a substantial association." Hence the question was raised whether price-fixing or price "administering" could be considered at all conducive to recovery.

Regulation of Production

In many industries, especially those with very large amounts of unused capacity, cost protection was regarded as highly inadequate for solving market difficulties. Additional devices were urged for inclusion in codes and were approved in a considerable number of instances. Such devices were of course intended to protect vested interests against existing or forthcoming competition, and in some instances no doubt to facilitate the maintenance or creation of collective monopolies. This was especially true of methods adopted for regulating production; and the picture presented in a survey of these methods reveals a strong resemblance to certain features of cartel policy.

[20] *Hours, Wages and Employment under the Codes*, NRA, January 1935, p. 102.

Among the code provisions set up with a view to restricting production, three main classes may be distinguished, each representing a different line of approach: (1) those meant to prevent the expansion of capacity; (2) those placing restrictions upon the volume of current production through limitations upon machine and plant operations; and (3) those dealing directly with production allocation and control. In the order of enumeration, these three classes of provisions come into closer fulfillment of the requirements of cartel policy.

The iron and steel code was an outstanding example of the first class, providing for strict prohibition of increasing existing capacities for producing pig iron and steel ingots. In a considerable number of other codes, expansion of capacity was made dependent upon special authorization, exceptions being granted in many cases for modernization and replacement. In order to provide for an efficient control of such provisions, registration of productive machinery or other capacity was required by some codes. In a few instances such plans were supplemented by plans for scrapping obsolete equipment through collective purchase.

The provisions of the second type, limiting hours of machine or plant operation, represented an indirect and crude method of reducing output. It was one which had been resorted to by many European cartels in the early stages of development. The widest application of this procedure was made in the codes for the textile industries. Since no heed was taken of the differences in efficiency of the various plants, limitations upon the number and length of working shifts operated to reduce the output in varying degrees from plant to plant and to distribute in a highly unequal manner the advantages expected by competing firms from a reduction of

output. In an imperfect way this plan had aspects of a quota system, since it indirectly allocated to firms different shares in the aggregate production from what they would otherwise have had. Its primary purpose was that of any cartel, improved financial prospects based on restricted output.

Definite provisions of the third type, involving some sort of planning, pooling, and allocation of production, were to be found in a very limited number of codes only; but by reason of their potential bearing on the future developments of the competitive system, they deserve special attention. Several different types of provisions may be distinguished under this heading. There were included in a few codes recommendations for acquisition and disposal of surplus used equipment, or for the scrapping of fully depreciated obsolete equipment, or for closing down or amortization of the less economical plants. These were in line with the idea of "industrial planning" for maintaining proper balance between productive capacity and expected demand.

A number of codes provided merely in general terms for potential or prospective regulation of production under conditions left for future determination. This was true of the iron and steel code. Still further in the direction of cartel-like combinations were provisions authorizing the members of the industry to enter into voluntary agreements for sharing the market. Thus, under the cement code, plans were to be formulated which upon approval by the head of the NRA, would provide "for the equitable allocation of available business among all members of the industry or among members of the industry operating in one or more districts, and for a general control of the cement industry."

But by far the most important restrictions of produc-

tion were found in codes which provided for outright allocation of production quotas to each member in an industry in accordance with a plan established by the code authority. Apart from a very few minor cases, three codes dealing with basic products were of this sort. Under the petroleum code, the amount of crude oil required to balance consumer demand for petroleum products was to be estimated at intervals by a federal agency and to be equitably allocated among the several states. Adequate subdivisions into pool, lease, and well quotas of the production were to be allocated within each state, and specific measures were provided for cases in which the regulation of production by states failed to comply with the general set-up. Complementary provisions dealt with the refining process, which was to be adjusted by sub-committees appointed in each refining district. Under the lumber and timber products code, production quota allotments were to be assigned to each division and subdivision of the industry and individual allotments were then to be assigned in each division. Under the copper code a comprehensive sales plan was provided, based on the estimated annual production capacities of the primary producers and allotting to each monthly sales quotas. In addition, aggregate sales quotas were allocated among the producers of secondary copper.

Plans of the sort just described were decidedly cartel-like in their methods of control, and partook of the nature of compulsory cartels. It is, however, of interest that the relatively full expression of the cartel form was permitted under the NRA only in natural resource industries where a somewhat special interest attaches to the matter of wasting resources. There are rather special arguments for the control of production in these indus-

tries under a policy of conservation. As the codes actually operated, however, they seem to have been directed but slightly toward conservation ends, and operated mainly to serve the usual cartel ends of enhancing the profits and preserving the equities of private owners. Whether or not, when public considerations dictate monopolistic control of production in the natural resource industries, it should be left to private enterprises under public control or should be undertaken by a public authority is a question which goes beyond the limits of the present discussion.

Finally, a similarity to cartels also appeared in some instances in the method of enforcement employed by industries. This is illustrated by the iron and steel code. A special voluntary agreement was entered into by the majority of the industry by virtue of which the parties to the agreement acknowledged the code as constituting a valid and binding contract and pledged themselves to pay a fine of ten dollars per ton sold in violation of any code provision. The funds thus collected were to be distributed among the other members of the code agreement. This procedure is obviously akin to certain cartel methods adopted with a view to equalizing profits in spite of violations of contractual obligations.

It is worth noting that the compulsory character of codes generally tended to increase the cartel-like character of their effects. One of the reasons for the adoption of production control by voluntary cartels is the relative ineffectiveness of mere price agreements as a means of market control. Such agreements are too ephemeral, too easily broken. Were they really implemented and enforced, however, compulsory price provisions would themselves effect a restriction of production. They would also serve to insure high-cost enterprises a place

in the market. The impulsions which lie back of the allocation of production would thus in some degree be lessened. Price control when enforced by legal and administrative provisions is likely to take an intermediate position, as to its effects on competition, between merely voluntary price-fixing and outright control of production. Stabilization of competitive conditions may, at least indirectly, be promoted by this type of industrial policy and maintenance of a profitable price level, for a given industry involves shifting a part of the burden of risk-bearing to other economic groups.

THE TREND OF POLICY

The Recovery Act authorized two further means of restricting competition apart from codes: the power conferred on the President to require a license to do business in any line covered by a code, and the power to restrict imports if necessary for the maintenance of any code. These powers have the appearance of deriving from an advanced cartel philosophy and might well have been used to form the corner-stone of a system of enforced cartelization. The powers were not used; and the reluctance of the Executive to use them may be considered indicative of the general attitude of the Administration, which increasingly came to question the effects exerted on the general trend of business activity by the introduction of monopolistic devices into many industries. The problem how to protect the consumer's interests against the use of the new powers vested in well-organized industries proved as insoluble as had been the case with the same problem when tackled in European countries.

As time went on, after codes including monopolistic elements had been approved, the drift of Administra-

tion policy was back in the direction of traditional anti-monopolistic sentiment. This came up in the guise of increasing regard for the consumer's interest and took the specific form of making it difficult to put into effect the price-control provisions of the codes. This ultimate hesitation and withdrawal emphasized the degree to which the NRA had early thoughtlessly drifted with the tide of cartelizing tendencies, looking at the problems of each industry through the eyes of those financially interested and lacking any scheme of analysis for the composite of economic effects.

Though the general later trend of economic policy may therefore be regarded as opposed to outright cartelization tendencies, there remains the obvious fact that organization of industries on market lines provoked and achieved by the code-making process resulted in providing these tendencies with a groundwork of firmly established industrial associations, many of which were moved primarily by the desire to get control over the market. The pursuit of self-government in industry meant in the last resort a fight for the recognition of the principle of market control. Prospective conflicts between the Administration—aware of the dangers threatening from the spread of collective monopolies—and the powers embodied in the trade association movement stood out in bold relief. With important exceptions, the spirit of co-operative action called forth to assist in bringing about recovery turned out to be after all the spirit of cartelization, and "controlled competition" increasingly disclosed its ultimate objectives, namely, control of markets by collective monopolies.

In the later stages of the NRA code system, before the Supreme Court decision in the Schechter case, the direction which further developments in industrial or-

ganization were to take was still not clear. The traditional atomistic policy was again coming into view at the same time that groups organized for collective action were occupying a more or less intrenched position. Their position was, however, not well fortified on the side of administration and enforcement. The pending test of forces was over the issue whether the government would undermine the position by removing monopolistic features, or permit it to be undermined by its own inherent weaknesses, or support it by substituting effective for ineffective means. What the exact outcome would have been from industry to industry, no one can say. But it is perhaps a fairly justified assumption that, though marked by breakdown in various areas, the system under development would have left important elements of market control in their entrenched position; and that the growing strength or weakness of these elements would in considerable degree have depended on whether or not a prolonged state of market weakness made their continuance worth bitterly fighting for.

Since the Supreme Court decision in the Schechter case the prospects are even more incapable of analysis. For the time being, officially, the atomistic policy of maintaining free competition is in force. To what extent under-cover combinations in violation of the anti-trust laws will continue there is no way of knowing. Nor can the instances of non-collusive market leadership be counted. The reasonable assumption, however, is that both will be more numerous than heretofore, and that the facts of industrial organization will therefore deviate further from the official presumption of competitive organization.

The Schechter decision, though in effect dissolving the NRA, did not lessen the underlying pressure of eco-

nomic forces which are so conducive to collective business action. It is therefore not perhaps amiss in conclusion to restate briefly the character of the relationship between market conditions and the character of new developments in industrial organization.

CHAPTER VIII

THE WIDER VIEW

Our analysis has shown that as long as there exists in a capitalist economy a prevalent trend towards expanding markets, free competition can easily be maintained in most areas of industry by appropriate legislative and administrative measures. It has indeed a strong tendency to maintain itself. Unless secured by monopolization of essential materials, routes of transportation, or patents, monopolistic positions can hardly ever be effectively protected against the rise of competitive rivals. Monopolistic tendencies in periods of expanding markets typically take the form of large corporate combinations which are formed with a view to improving profit-making possibilities by means of increased efficiency of large-scale operation. If such combinations are able to secure monopoly and to reap exorbitant profits, measures of taxation are not lacking to collect and utilize such profits for social purposes and thus to remove the dangers involved in their free private use. The serious problems of corporate monopoly, apart from the public utility field, can thus be reduced to those involving limited natural resources and patents. Corporate concentration short of monopoly may, however, facilitate the formation of collective monopolies of cartel type.

Monopolies originating from the pressure of contracting markets are almost without exception not of the single, but of the collectivist type. They mitigate the bitterness of competitive struggle in the selective process of industrial survival. If, however, such monopolies spread widely through the industrial system, they seri-

ously impair its adaptability to changing conditions, by reason of the rigidity of prices and the enhanced fluctuation of output and employment. The greater the decline of prices and the more prolonged its duration, the stronger is the tendency towards the creation of collective monopolies which will operate against the process of general mutual adaptation of costs and prices. Governments do not deliberately choose to facilitate this development. Rather they merely tend to give way before the dominant economic forces either with or without an approving attitude. In so doing they commonly do not understand the character of the economic effects of their actions; or if they do, prefer them to any feasible alternatives such as the continuance of bitter competitive struggles.

Evidence goes to show that administrative supervision of cartel activities may perhaps succeed in preventing cartels from the extremes of exploitation of consumers, and in mitigating the "abusive" pressure upon members of the industry whose interests diverge from those of the majority or of leading concerns. But there exist inherent in the very nature of any cartelization movement certain highly undesirable tendencies which no governmental regimentation can even attempt to eliminate. These are the tendencies to reserve the markets exclusively to those concerns which happen to be members of the combination and to stabilize prices as against stabilization of production and employment.

Cartelization means isolated planning. Cartel policy as derived from the interests of a particular industry is bound to be pursued apart from and independently of any other economic policy intended to facilitate the adaptation of the economic system to changing conditions of the markets. Rigidity of prices enforced for cer-

tain groups of commodities, especially of goods representing important cost elements of later stages of processing, is bound to impair the restoration of the economic equilibrium whenever it has been seriously disturbed by the course of business fluctuations. Such are in general the effects of cartelization on the economic system which even the wisest and most far-sighted governmental control is not in a position to prevent.

It is therefore impossible to regard cartelization of itself as a development capable of improving any of the serious defects of the economic system. It represents merely the defensive gestures of private groups attempting to protect themselves from the effects of economic instability. The more extensive this development, the more seriously are the stability and productivity of the economic system threatened.

Economists are well assured that the more serious aspects of instability are related to defects of the monetary and credit system. Were financial control to be improved, the motivation of defensive cartelization would diminish; and on this assumption some economists think that collective business action might find "professional" forms of self-discipline; that is, forms consistent with the public interest.[1]

The economic philosophy underlying such a view is akin to cartel philosophy in so far as it is based on the assumption that there exists, particularly for many capital goods producing industries, a permanent tendency to expand in boom periods beyond the needs of their markets. Important divergences of view exist mainly as to the efficacy of any feasible system of credit control to check over-expansion in prosperity periods and to facilitate adjustment in ensuing depressions.

[1] See Arthur Salter, *The Framework of an Ordered Society*, p. 36.

The American outlook in the past has reflected the expectation of expanding markets, and its legislative policy has been dominated by this fact. Correlatively, the combination movement in the United States has typically taken the form of large corporate combinations, interrupted during periods of depression which were not marked by the rise of collective combinations. During the present depression, official policy under the NRA for the first time temporarily facilitated collective combinations animated by a philosophy substantially similar to that of cartelization.[2] If the trend of general expansion characteristic of America's past history should definitely be superseded by the opposite trend or at least by an economic development marked by heavy and long-lasting depressions, the forces which inspired the temporary deviation from past policy may be expected to continue with increased strength. Under the pressure of long-lasting market contractions, the American situation would more closely correspond to that already reached in many European countries; and cartelization might be expected to gain a firm foothold and deeply modify the structure of the American economy. Instead of consisting of an irregular trend toward corporate combination as in the past, the combination movement might then be expected to respond to the

[2] It seems hardly necessary to insist upon the obvious fact that important aspects of this "depression" philosophy are equally fundamental to the system of production control adopted under recent agricultural legislation. The effects on the price and profit structure resulting from over-capacity of productive elements are met by schemes providing for adjustment of output to support higher prices. It is true that these schemes have been suggested by heavy declines of the export trade rather than by weakness of the home market, which is characteristic of many industries, especially those producing capital goods. But the essential objectives of this legislative and administrative policy, whether applied to agricultural or to industrial production, are based on reasoning which never noticeably influenced American economic policy until it provided the New Deal with one of its most striking features.

wave-like expansions and contractions of business by alternating between the rise of corporate combinations and the creation of collective combinations of cartel type.

Should this development occur, cartelization in this country might take forms and features largely divergent from those experienced by other countries. The demand stressed by organized business groups to be granted the right to conclude free voluntary agreements exempted from the provisions of the anti-monopolistic legislation might meet with insuperable political obstacles. Collective control of prices, not to speak of the creation of outright collective monopolies, might be made, as happened under the NRA, the object of a considerable degree of governmental supervision. Hence regulated cartelization might become the characteristic feature of the new development, in contrast with voluntary cartelization as it developed in most European countries not hampered by anti-monopolistic legislation.

Looking forward there may be perceived three main lines of development of future economic organization within a capitalist system. Broadly speaking, the first would be marked by the relatively full maintenance of free competition; the second would introduce what may be termed self-government of industries, resulting in the gradual development of a system of collective monopolies in industries with heavy capital investments; and the third would lead to some sort of planned economy controlled by a central governmental authority. Each line is dependent upon the application to the industrial set-up of a specific risk concept: free competition, on the maintenance in principle of the individual risk of each undertaking; self-government of industries, on the creation of some sort of collective means of risk

avoidance;[3] state controlled planning, on the assumption by the state of the ultimate risk involved in operating controlled plants, since their owners could hardly be made responsible for losses due to an industrial policy over which they had little control.

Whether or not the competitive system is to be maintained is likely to be determined by the general trend of economic conditions. Its continued effective functioning, as in the past, is conditional upon the return of expanding markets, which will give new incentives to competitive activities, and upon a prospect that the fatal overstraining of credit supply and ensuing undue capital investment can be avoided in future by improvements of the monetary and credit machinery.

One of the other two lines of development would result from the opposite view—eventually forced upon government and business by the course of economic events—that lasting expansions of markets are not to be counted upon and that serious and prolonged depressions are bound to occur. Under such circumstances the inference may be safely drawn that economic forces would work strongly toward some sort of deliberate, administered adjustment of supply to demand, as the functioning of the price mechanism under a system of free competition would be considered inadequate for the fulfillment of this task.

The essential distinction between the two lines of "controlled" development is the different nature of the machinery set up for providing for the adjustments. The machinery envisaged under the rule of "self-government of industry" is intended to secure each group of competitive undertakings the power to pursue its collective interests independently of the interests of other

[3] See pp. 9 ff.

groups. This development would be more or less tantamount to cartelization.

However, unless by recurrent favorable business conditions the self-defensive policy of organized group interests is weakened in vigor and effect, the strong need for governmental control of the main lines of productive activity might result from insight into the exact nature and consequences of conflicting monopolistic tendencies. In this case collective monopolies, far from being prevented and outlawed, might be under certain conditions even created and enforced upon reluctant members of important basic industries. Instead of charging self-governing industries with the task of adjusting demand to supply, some central authority might be vested with the power of directing production and expansion according to some pre-established plan in a way considered best fitted to secure balanced operation of the economic system. Regulation might be extended even to later stages of processing.

Such a scheme would imply the adoption of measures passing far beyond those adopted by either the Fascist or the National-Socialist economic policies, which are still largely influenced by the idea of self-government of industry. Attempts made to regulate the national economy up to the present have been more or less of the makeshift type and meant to meet special calamities. No constructive scheme has yet been devised to coordinate under governmental control the functioning of strong collective monopolies vested in important capital goods producing industries.

There can be no doubt that the creation of such monopolies, as shown by the history of the cartelization movement, is likely, in the field of international commercial relations, to strengthen the tendencies directed

towards national self-sufficiency as opposed to international understandings promoting freedom of trade.[4] It is an open question to what extent far-reaching and comprehensive governmental control of industry and trade might be consistent with the functioning of democratic institutions in other lines of public life. Such control to be efficient could hardly be made dependent upon the decisions of changing political majorities but would have to be backed by a firmly established authoritative system.

There is every prospect that in America, as elsewhere, economic organization will undergo mixed developments, showing traces of each of the three tendencies just noted. What cannot be prognosticated with any confidence is which one will in the long run assume the dominant role. Should developments lead to either collective monopolies or a "regulated" economy, economic evolution will be marked by conditions of bitter economic travail. Without endorsing all implications of the materialist interpretation of history, one is tempted to suggest the view that the ultimate decision will rest with the frequency and severity of business fluctuations which may or may not be conducive to the maintenance of the competitive system.

[4] The trend towards increasing "the integration of the economic organization into a national system" is shown to be a characteristic feature also of the policy of the New Deal by J. C. King, "Nationalism," *Social Changes and the New Deal* (edited by W. F. Ogburn), 1934, p. 97.

THE CARTELIZATION MOVEMENT IN EUROPE

APPENDIX

THE CARTELIZATION MOVEMENT IN EUROPE

The following outline is not meant to give a history of the development of European cartelization. It is intended primarily to show the close correlation existing between this development and the alternative phases of expanding and contracting markets. So far as prosperity periods can be shown to be conducive to the creation of corporate or other financially unified combinations, this development is also granted a place in the picture. Moreover, it seems appropriate to grant some consideration to changes of public opinion and public policy experienced in various countries with regard to the cartelization movement. Hence this outline may serve to illustrate such issues as were discussed in earlier chapters, especially those dealing with the nature of cartels, with cartel policy, and with state policy toward cartelization. Since the correlation with business fluctuations is stressed, it may be reiterated that the cartel concept is confined to collective combinations which protect their market position through control of production; and excludes loose price associations, selling-terms agreements, and the like, which represent a different type of monopolistic organization and arise under the most varied sets of market circumstances.

GERMANY

Germany is practically the only important industrialized country in which both cartels and unified combinations have developed to a fairly high degree.[1] In almost

[1] Had the Austro-Hungarian economy not been dissolved by the consequences of the World War, an examination of it, from this point of view, would probably be equally interesting.

all other European countries the cartel movement has made extensive headway only in recent times—since the end of the World War. Germany is therefore the primary laboratory of cartel experience.

Pre-War Cartelization

This history of pre-war cartelization in Germany can adequately be divided into three periods: 1872–90, 1890–1905, and 1905–14.

The Period 1872–90

The first important period of cartelization in Germany comprises about fourteen years of generally depressed business conditions following upon an extravagant boom which was suddenly brought to an end by the crash of May 1872. This phase of depression, lasting until the middle of 1886, was interrupted by two short periods of more favorable business conditions (March–December 1879 and March 1881–January 1882) which, however, did not considerably improve general business conditions.[2]

The preceding boom had led, especially in the heavy industries, not only to the creation of a large number of new enterprises, but also to important outright mergers (Dortmunder Union, 1872, in the Ruhr district; Vereinigte Königs und Laurahütte Akt. Ges., 1871; Oberschlesische Eisenbahnbedarfs Akt. Ges., 1871, in the territory of Silesia; the Lauchhammerblock in Saxony, 1872; and so on). Vertical consolidation also, extending

[2] Thanks to the elaborate studies made by Professor W. C. Mitchell into the course of business fluctuations of some highly industrialized countries (United States, France, Germany, and Great Britain), we are in a position to establish adequate relations between the natal dates of the important combinations and the phases of the cyclical movements in which they fell. The present writer was privileged to receive from Professor Mitchell a preliminary draft of Chaps. I and II of *Business Cycles*, Vol. II, "Analysis of Cyclical Behavior," where the alternate periods of "expansion" and "contraction" are defined for the countries mentioned above.

over a range of processes, such as coal-mining, iron-ore mining, and raw-iron and steel production, had been instrumental in introducing profound structural changes in the German economy which had rapidly developed under the spell of prosperity set aflame by the payment of French war indemnity.

Thus, when a severe crisis followed by a prolonged depression set in about the middle of 1872, exaggerated productive capacity, faced with the restricted needs of slackening markets, led to very keen competition. It is easy to understand that the idea of coping with this disastrous situation by agreements restricting output and regulating sales gained headway. There existed earlier precedents for such arrangements in occasional agreements between small groups of firms in the pig-iron and tin-plate industries.

The years from 1875 to 1878 were marked by the creation in the Ruhr district of various coal-mining associations which afterwards—until 1885—resorted to restrictions of output by 10 per cent. After 1879 protectionist tariff policy, largely promoted by the insistence on the part of the heavy industries that the interests of their over-capitalized concerns be safeguarded against foreign competition, provided an adequate basis for cartelization purposes. The period covering the years 1882–86 generated the first important regional cartels of the coke industry (Koksvereinigung, 1882; Vereinigung der Koksanstalten in Dortmund, 1885). This movement was paralleled by organizations of the pig-iron producers (Rhenish-Westphalian Roheisenverband, 1886, comprising about 20 concerns partly "pure," partly "mixed"); of the rolling mills (Verkaufsorganisation der Feineisenwalzwerke of Upper Silesia, 1885); and of the potash producers (Karnellitsyndikat, 1883; potash cartel, 1886). So striking was the change of economic structure consequent upon this development that as early as 1883, Kleinwächter,

professor at the Austrian University of Czernowitz[3] and the first economist to make cartels the object of a scientific inquiry, went so far as to approve them as a pioneer foundation for a state controlled economy, organized with a view to adapting production to the lasting needs of the market.

The cartelization movement came almost to a complete standstill during the prosperity period beginning in the autumn of 1886 and ending in the spring of 1890. This period was in turn favorable to the expansion of the existing concerns, to the creation of new ones, and, what mainly matters in this connection, to important amalgamations. Thus, to quote some examples, in 1889 the Oberschlesische Eisen industrie A. G. resulted from a merger of two large concerns, and the Bergwerks A. G. Consolidation (Gelsenskirchen) from a similar procedure. Three large establishments situated partly in Germany and partly in Austria were amalgamated by the middle of July 1890 into the powerful Mannesmann Concern.

The Period 1890–1905

When expansion stopped a new cartelization move set in, extending over the depression period which ended early in 1895. This period is marked by successful efforts to effect strongly knit combinations in the mining and heavy industries of large industrial areas. Leading in this field were again coal-mining (Westphalian Coal Syndicate, 1890; Rhenish-Westphalian Coal Syndicate, 1893, representing almost 87 per cent of the total coal output of the mining district of the Ruhr) and iron and steel (Verkaufstelle für Giesserei-Roheisen, 1893; Verein für den Verkauf von Siegerlander Roheisen, 1894; Verkaufstelle für Stahleisen, 1894, etc.). Sooner or later the same tendency resulted in the creation of re-

[3] Czernowitz is the capital of the "Bukowina," then a part of Austria but assigned by the peace treaty to Rumania.

gional cartels in other lines of production such as sodium hydrate (1891), cement (1894), plate glass (1894), and so on.

Contraction of the market was relieved by expansion from March 1895 to March 1900; but most of the existing cartels maintained their existence, apart from some cartels created in the chemical industry. However, the organization of the Düsseldorfer Roheisensyndikat, 1896, by which the existing regional associations were combined in a union covering a large industrial district, is the only important cartel which was formed during this period. On the other hand, important concerns were enlarged by amalgamations (Phoenix A. G., 1896–98; Rheinische Stahlwerke, 1900).

The period during which cartelization on a nationwide scale became basic to important strata of the economic structure of Germany extends from the spring of 1900 to early 1905, and comprises two phases of economic contraction interrupted by a relatively short upswing movement starting in April 1902 and ending in July 1903. In 1900 and 1901 soft-coal producers followed the example set by other lines of coal mining (Rheinisches and Sächsisches Braunkohlensyndikat). The pig-iron cartel already existing in Rhenish-Westphalia was paralleled by a similar organization in Silesia.

From raw materials, control of the market spread over the products of later processes of manufacture: steel girders, strong tinned iron and tin plate, steel moulding, rails, wire rolling and semi-finished iron goods (Deutscher Trägerverband created out of two regional cartels; Verband Deutscher Grobblechwalzwerke at Essen; Verband deutscher Feinblechwalzwerke at Cologne; and Stahlformgussverband, Deutsche Schienengemeinschaft Verband deutscher Drahtwalzwerke, Halbzeugverband, all at Düsseldorf). Cartelization of later stages of productive processes, especially in the

iron and steel industry, was favored by the system of export bounties granted by the cartels of producers of raw materials with a view to adjusting the competitive strength of the producers of semi-finished goods to the conditions obtaining on markets abroad.[4] As early as 1902 a special counting office was established by the Coal Syndicate of Essen for controlling the assessment of the export premiums in common with the steel girder cartel and the cartel of semi-finished iron goods.

Efforts to adapt production to a slackening market were renewed in 1903 and 1904 by the expansion of the Rhenish-Westphalian coal cartel, by the reconstruction of the pig-iron cartel of the same district and, above all, by the establishment of the Steel Works Association (Deutscher Stahlwerksverband), followed by a similar organization of the Upper Silesian steel works (Oberschlesischer Stahlwerksverband). The control of the home market was strengthened by international agreements (International Rail Manufacturers Association, International Tubes Cartel). Lime, cement, copper sheets, high-tension cables, and chemicals were made the object of conventions, mostly regional.

The Period 1905–14

By 1905 the economic structure of Germany, as far as it was to be determined by the cartelization movement before the war, was almost completed. There started in March 1905 a period of prolonged prosperity lasting until April 1913 and interrupted only by a short downward swing of business activity (August 1907 to October 1908). In this period the tendency towards amalgamation was uppermost. Consolidations on horizontal and even more on vertical lines contributed to the rapid expansion of important concerns in the iron and steel industry. Thus from 1905 to 1907 mergers were effected by the Oberschlesische Eisenbahnbedarfsge-

[4] See p. 71.

sellschaft, the Phoenix A. G., the Gelsenskirchner A. G., the Kattowitzer A. G., the Eschweiler Bergwerks A. G., and the Deutsche Erdöl A. G. After the interruption caused by depressed business conditions in 1907 and 1908 the consolidation movement revived by the end of the latter year and again numerous mergers marked the path of industrial development fostered by expanding markets. Some examples may be quoted: the Deutsch-Luxemburgische Bergwerke A. G., the Hösch, the Thyssen, and the Krupp concerns; the Lothringer Hüttenverein, the Kattowitzer A. G., the Rybek'sche Montanwerke, the Deutsch-Luxemburgischer Concern, the Deutsche Kaliwerke A. G., and the Kaliwerke Wintershall.

The same tendency was marked in the electro-technical industry by the vertical and horizontal expansion of the Siemens-Schuckert Combination and General Electric Company (Allgemeine Elektrizitätsgesellschaft). In the chemical industry there were two large combinations after 1905: Badische Anilin, Elberfelder Farben and Agfa (Aktiengesellschaft für Anilinfabrikation) on the one hand, and Höchster Farben, Kalle and Co., and Leopold Cassella and Co. on the other.

So thoroughgoing had been the process of amalgamation in the German iron and steel industry that a limited number of large industrial units had become dominant and had almost completely superseded smaller concerns which had failed to join this general evolutionary trend. In the cartels of this industry as well as of the chemical and the electro-technical ones, the primary objectives underlying cartelization—stabilization of the competitive conditions within the trade—had been deeply modified. Large integrated units were linked up with each other by cartels and syndicates, each of which controlled the market of products of successive stages of processing. Thus the way was prepared for increasing conflicts of interest arising out of the

tendency towards further expansion. The more the existence of the cartels was threatened by this rivalry, the less were powerful concerns willing to surrender the sale of their products to a joint cartel agency. Prolonged prosperity had fostered within the cartel the development of disrupting forces, which were, however, somewhat held in check by special schemes of quota allotment.

In 1913, as Beckerath has it,[5] "it seemed as though a final decision of the contest between the principles of cartelization and of corporate combination was imminent in the mining and iron industries and in some industries making producers' goods. Particularly in the production of raw materials were both principles carried to such a point that these industries were controlled by a few super-cartels and large syndicates, themselves composed of only a few large combines which made them tools of their production and sales policy. In fact, thus handicapped in their actions by differences arising among these combines, the super-cartels and large syndicates were in danger of being gradually dissolved."[6] In other lines of industries in which so-called cartelization developed in the years immediately before the war, the agreements were not strictly of cartel type. They were largely of the term-fixing and price-fixing type, and seldom resorted to quota-fixing and territory distributing methods.[7]

As the preceding brief account indicates, the inherent antagonism existing between cartelization strictly defined and economic conditions created by generally expanding markets is clearly brought out by the history of the German pre-war cartel movement.

It is an often debated question why Germany was,

[5] H. v. Beckerath, *Modern Industrial Organization*, 1933, p. 25.

[6] In 1910 the Potash Syndicate, threatened with breakdown, was maintained by compulsory legislation.

[7] Beckerath, *Modern Industrial Organization*, p. 27.

apart from Austria, the main country in which a comprehensive cartel movement developed. If this question were to be fully faced, certain considerations related to deep-seated national institutions and habits of thought would have some relevancy. Strong economic movements deeply rooted in the interests of those concerned are, however, at the base of the developments in all countries; and the divergences between countries are to be mainly explained by the differing market structures and the varying influence of economic groups in shaping national economic policy.

Thus the strength of the cartelization movement which impressed its stamp on the economic structure of pre-war Germany is to be explained primarily by the conditions prevailing on the markets of the principal German products. There was a considerable wealth of raw materials on which to build up a rapidly expanding industry out of the large savings of a thrifty population. The home market, however, though protected against foreign competition, was rather limited in its power to expand rapidly, and the expanding productive capacity in various industries endangered the prospects of a profitable market. Such a situation lent itself to the conception of the home market as something capable of being divided and distributed among the competing firms, as an offset to market weakness.

It is to be remembered in this connection that the intricate question of the extent to which the outlets of Germany's industry might be capable of steady and adequate expansion was eagerly discussed as far back as the beginning of the present century. Tightness of the German home market was contrasted to the vast prospects offered to expanding production in the "three economic world empires"—America, Great Britain, and Russia. Germany's claims to the acquisition of colonies and her naval policy were largely backed by such arguments and contributed to the creation of the interna-

tional tensions which finally resulted in the World War. Whatever other influences were at work, an inordinately rapid and somewhat unbalanced development of the productive structure must be given due weight.

Post-War Cartelization in Germany

The operation of strong economic movements in Germany such as cartelization and consolidation, though deeply modified by the war, were by no means arrested by it. The highest degree of business activity was forced upon all concerns whose output was needed for military purposes. To be sure, existing cartels and trade associations of various kinds were fitted into the war-time system of industrial organization which was designed to "ration" production according to the relative urgency of needs in the face of a depleted supply of raw materials and man-power. But by the compulsory measures adopted to serve these purposes the very nature of the industrial system was so deeply modified that war-time "cartels" can hardly be considered as representing the type of combination suggested by this term. Apart from some minor exceptions, applying for instance to certain construction trades suffering from serious declines in their business activity, there was no need to establish collective methods of risk avoidance for profit-making purposes. Owing to ample inflationist measures, connected with the system of financing the war, prices were constantly rising and orders were abundant for all concerns which fitted into the system of warfare economy. Restrictions and regulations decreed by the government and put into effect with the efficient assistance of industrial groups had nothing to do with the objectives commonly pursued by cartels.

Thus, far from fostering cartelization strictly so called, the war period was, like any other period of brisk business activity, rather favorable for giving a strong impetus to the more unified forms of combination. As a

matter of fact, a considerable number of mergers took place, especially during 1916 and 1917 (by such concerns as Krupp A. G., the Essener Stein-Kohlenbergwerke, the Deutsch-Luxemburgische Bergwerki und Hütten A. G., the Gelsenkirchner Bergwerke A. G., the Rheinische Stahlwerke, the Mannesmann concern, the Rombach concern, the Deutsche Erdöl A. G., the Wintershall A. G., and others).

The Period 1919–23

When the war was over a new phase of the combination movement set in. According to Warriner, this movement "differed essentially from the pre-war movement in that it affected every industry. Its rapidity and universality were due to one cause, and one cause only, the financial situation."[8] This way of presenting the problem hits the nail on the head. Germany's industrial post-war history was such as to lend strong support to the view that monetary and credit conditions are a prime factor in determining the course of the combination movement.

General economic conditions prevailing until about April 1925 were not of a nature to cause a revival of cartelization. Just the opposite was true. Increasing inflation largely favored expansion of production; it facilitated the reorganization of existing plants; and, finally, it created the "flight into real values," thus defeating attempts to arrive at understandings as to the probable purchasing capacity of the market of a given industry, basic to cartelization schemes.

Reconstruction of German industry was rendered necessary by the loss of highly industrialized territories such as Lorraine and Upper Silesia. The concerns situated in these territories had been essential elements of the economic structure of the empire and had been interwoven by numerous mergers with the fabric of Ger-

[8] D. Warriner, *Combines and Rationalization in Germany*, 1928, p. 7.

many's economy. Almost all large German iron and steel concerns were severely hit by the loss of mines and manufacturing plants located in the areas which had been surrendered by virtue of the peace treaty. Their financial situation, however, was rendered favorable by the large indemnities they received from the Reich as equivalents for their losses. Moreover, in a period of rapidly depreciating currency, borrowing was the best bargain imaginable for those who were in a position to do it.

Thus, owing to the complete disruption of the monetary and credit system, a wave of corporate combinations of amazing dimensions spread over Germany. With great rapidity many lines of industry and trade were interconnected. The movement mainly centered on outstanding industrialists such as Klöckner, Thyssen, Stumm, and above all Stinnes. Between 1919 and 1921 the Gutehoffnungshütte concern is reported to have performed nine mergers and Thyssen (Gewerkschaft Deutscher Kaiser), six mergers. The Klöckner concern effected nine mergers between 1918 and 1920; the Rheinische Stahlwerke seven mergers between 1920 and 1923; the old Mansfeld concern together with the Linke Hofmann concern was made basic to the mining supply of the A. E. G. (the large electrical company). Other combinations, however, were outdistanced by the activity of H. Stinnes, who in 1920 succeeded in establishing a comprehensive community of interests, including the Siemens-Rheinelbe-Schuckert-Union between three mining concerns (Gelsenberg, Deutsch-Luxemburg, and Bochumer Verein) and two large electrical concerns (Siemens and Halske A. G. and Elektrizitäts A. G., formerly Schuckert). Thus, for the first time in the economic history of Germany, all stages of production from raw material upwards to machines of the highest type and electrical appliances of the highest perfection were united by a strongly connected indus-

trial and financial body. Not less than thirteen important mergers and a considerable number of minor ones were effected by the Siemens-Rheinelbe-Schuckert-Union during the years in which the purchasing power of the German currency rapidly dwindled away. Moreover, a large group of soft-coal mines, oil works, and other heterogeneous establishments like wharfs, mercantile enterprises, banks, shipping companies, glass, cellulose and paper factories, printing establishments, hotels, and so on, were acquired by the mammoth combine controlled by Stinnes.

As a result of this movement the number of independent competitive firms steadily decreased in most lines of trade in which the amount of capital investment played a decisive part and in which important advantages were to be gained by co-ordinating productive processes distributed over a large range of establishments according to unified plans. Thus amalgamation became fundamental to the sweeping process of rationalization which during the following years became an essential characteristic of Germany's industrial development.

While the consolidation movement was in rapid progress, cartels were being dissolved or just formally maintained. "Death of cartels" ("*Kartellsterben*") was registered by many reports of commercial and industrial corporations. Economic experts called cartelization an "antiquated" movement which was progressively being replaced by corporate combinations following the American pattern.[9] Decay of cartels was especially perceptible in industries where they had been deeply rooted before. In other industries the more highly organized cartels were transformed into associations of a lower type, syndicates into price-fixing associations. Price-fixing associations restricted their activities to the es-

[9] See M. Metzner, *Kartelle und Kartellpolitik*, Berlin, 1926, p. 43.

tablishment of minimum prices or abstained even from any interference with price-fixing.

As a matter of fact, during the inflation period cartels were created or renewed almost exclusively by virtue of compulsory measures under "socialization" laws passed by the legislative bodies with a view to preparing the ground for a more highly regulated economy. In the fields of mining and heavy industry, all concerns within each industry were to be strongly knit together by comprehensive forced cartels. The production and price policies of these cartels were to be controlled by central bodies on which not only employers, but employees and consumers as well, were to be represented; and government officials were to be granted additional supervisory authority. Venturesome plans of this kind materialized only to a very limited extent, and it is difficult to say to what extent they resulted in changes of the economic structure which might not have been brought about apart from any compulsory measures.

Under the socialization scheme, coal-mining was organized by regional cartels headed by a central administrative machinery. Compulsory cartelization of potash production, which had already been decreed before the war (1910) in order to secure ample exploitation of the potash monopoly then held by the German mines, was renewed and made basic to an understanding with the French government, which had gained possession of the mines situated in the territory of Alsace. The gas-coke-cartel also came under the scheme. But legislation failed in attempts to extend the scheme to other lines of industry. The "Union of Iron Producers and Manufacturers" (Eisenwirtschftsbund), which had been meant to establish compulsory cartelization in German heavy industry, hardly passed beyond the law by which it was created; and the act providing for government control of the electrical power industry remained a dead letter. When the short wave of socialistic tendencies had gone by,

economic forces actively operated towards corporate combination rather than towards cartelization.

During the period of inflation, however, there existed in many industries a strong movement for effecting certain kinds of highly efficient agreements which were termed "cartels" in common speech and heavily attacked in certain quarters. So strong was this reaction that the German cartel decree issued in the fall of 1923 can be considered as an attempt to calm the storm. These agreements were not actually of a cartel type, nor were they even price-fixing schemes. They were selling-terms conventions and true offspring of the inflation period, since the agreements consisted of a pledge to enforce uniform terms of selling contracts (restriction of credit terms, execution of payment in advance of delivery, enforcement of some form of gold clause, etc.), by which the parties to them could shift to buyers the risks involved in the vanishing purchasing power of the currency.[10] As a matter of fact, all "cartels" of this kind disappeared or were transformed when stabilization of the currency took place shortly after the decree had been issued. To the great surprise of some of the authors of the decree, the very article of it which had been directed against the activity of these "cartels" so violently criticised during the inflation period, hardly ever was made use of in practice.

The Period 1924–33

The picture presented by the eventful economic development of post-war Germany again completely

[10] This development is to be kept in mind in interpreting the often quoted figure of about 1,500 industrial cartels existing in Germany in 1923. This estimate was made by Dr. Max Metzner, who was assisted by the Federation of German Industrialists. In discussing the nature of the combinations covered by his inquiry, Metzner (*Kartelle und Kartellpolitik*, p. 15) expressly stated that the number of cartels of the higher types was very small. The majority of the combinations belonged to the selling-terms type. About 500 to 600 were price associations.

changed when the currency was definitely stabilized and, after an expansion period covering about 15 months (December 1923 to March 1925), a serious depression began in April 1925. The recession was due largely to lack of capital, since the saving capacity of the country had been completely exhausted by the disastrous effects of the gigantic inflationary process. Many seemingly powerful corporate combinations built up with borrowed money were threatened with ruin; and a large series of transactions followed, leading to the breaking up of many of the elaborate combinations and communities of interest which had been put together a few years earlier. Now "death of trusts," that is of the large combines, was the order of the day, and almost all leading firms of the heavy industry were more or less badly hit. Phönix, Rheinische Stahlwerke, Krupp, all had to give up the control of important plants which they had acquired under the spell of inflation. The Stumm concern and the Rombach concern retained ownership only of their mining interests. The staggering trust structure of combines and amalgamations built up by Stinnes completely collapsed and had to be dissolved into its constituent parts.

This process of liquidation was paralleled by a revival of cartel activity which closely corresponded to the re-restrictive conditions prevailing on the market. Among the first cartels to be reorganized was the Rhenish-Westphalian coal cartel, which made a heavy curtailment of production applicable even to the self-consumed output of "mixed" enterprises. Of the large range of cartels which before had existed in the iron and steel industry, the pig-iron cartel was the only one which had survived the inflation period. It resumed its activities but, owing to the rapid progress of vertical consolidation, only a relatively small percentage of the output was available for sales on the open market.

The Steel Works Association (Stahlwerksverband),

which had lapsed in 1919, was re-established in 1924 as head cartel of a long list of steel cartels subjected to its control. These cartels extended over products such as bar iron, band iron, thick sheet, rolled wire, wire, steel ingot, and so-called *A* products (half-finished products, railroad structural steel, and figured bar iron).

Similarly, in almost all lines of trade in which attempts to control the market had been successfully undertaken in pre-war times, like endeavors were now renewed (in the cement, glass, limestone, and other industries). In other lines new cartels were formed. Thus, the chemical industry was covered by a network of agreements regulating output and prices.

It is a striking fact that, probably for the first time in Germany's economic history, this movement was hardly checked by the marked upswing which set in about April 1926 and gave rise to a new move toward consolidation, much sounder in nature than the preceding one caused by inflation. Cartelization proceeded hand in hand with corporate combination and industrial rationalization. This combination of the two tendencies in a single period, apparently contradictory to the view presented in the foregoing analysis that one or the other predominates at any given time, must be attributed to a very special conjuncture of circumstances.

The country's saving capacity having been largely exhausted, business expansion was dependent primarily upon borrowing abroad, especially in America. Mergers were promoted by the existing opportunity for large and promising German enterprises to have capital loans floated in New York, while this source of capital supply was hardly accessible to minor firms. The capital was available for introducing improvements into Germany's productive equipment, but under circumstances which peculiarly penalized weaker enterprises. The inflow of foreign funds was uneven and undependable. Events foreboding political tensions or market recessions would

abruptly interrupt it and lead to the withdrawal of foreign credits. The continued flow of funds was predicated both upon their use to increase industrial efficiency and upon the attainment of market control to prevent the competitive dissipation of capital values.

Therefore it is probably correct to say that the same conditions which prevented cartelization from experiencing a serious set-back during the prosperity period of 1926–27 were equally instrumental in determining the nature of some important mergers which were then effected. The tendency towards expansion of productive capacity was modified by specific financial considerations, resulting from the need to strengthen the financial backing of competitive concerns. Cartel agreements continued to be made for this purpose. There existed, moreover, in important lines of industry lasting overcapacity of production, due partly to the war, partly to the loss of foreign markets consequent upon increasing external competition, and partly to the investment policy pursued during the inflation period. Concentration of production in the most efficient establishments and mass production distributed over a large range of highly specialized plants under centralized control were made the first objectives of this new process of consolidation.

These developments were not dictated merely by the peculiarities of the capital market. What was going on was a far-flung readjustment to a fundamental change, a *Strukturwandlung*, in the circumstances of German industry, dictated by the effects of the war, of the German inflation, and of the world-wide boom centering in the United States. The much talked of "rationalization" movement was closely related to this set of circumstances.[11] The process, as it actually worked out, entailed both cartel agreements for market control and a most urgent drive toward productive efficiency. The results in the latter field were very striking.

[11] For the definition of rationalization, see p. 125.

In the potash industry, partly by compulsory measures, many unprofitable mines were closed down. The "Wintershall block" was created out of four large enterprises; and an opposing group formed a similar combination, the "Vereinigte Kaliwerke G. M. B. H." Horizontal combination was followed by vertical integration with undertakings engaged in later states of processing.[12] No less far-reaching were the changes brought about in the coal-mining industry, especially of the Ruhr district, by a concerted plan intended to concentrate production in the mines which were the least expensive to work.

In the chemical industry step by step the leading concerns were combined into a comprehensive economic and financial unit, the Dye Trust (Interessengemeinschaft Farben-industrie, commonly called I. G. Farben), the definite structure of which was established in 1925. Control of important sources of raw material supply (coal, coke, lignite) was secured by mergers as well as by financial interlocking, creation of communities of interest, and so on. On the other hand, the scope of the trust's activity was extended to finishing processes based on the consumption of chemical products (weaving of artificial silk, nitrogen fertilizers, liquid fuel, photography, and so on). In the electrical industry important vertical combinations were effected especially by the Rheinisch-Westphälische Elektrizitätswerk of Essen, the most important producer of electric power in Germany which acquired large participations in coal and lignite mining and in power-using undertakings.

By far the most striking result of this concentration movement was the foundation of the United Steel Works (Vereinigte Stahlwerke) in May 1926. By this economic and financial operation seven large concerns of the Rhenish-Westphalian iron and steel industry hitherto controlled by four independent financial groups

[12] See p. 125 n.

became a single productive organization for the purpose of complete rationalization of productive activities.[13] The example set in the Ruhr district was followed in German Upper Silesia by a corporate combination (Vereinigte Oberschlesische Huttenwerke A. G.) agreed upon by three leading concerns. As a link between the western and the eastern iron and steel combinations a kindred organization was created, by common understanding, in Central Germany (the Mitteldeutsche Stahlwerke).

One of the characteristics of the new movement was a horizontal combination of plants which had heretofore been the separate properties of the large integrated companies. Thus the production of high-grade steel was similarly centralized by the foundation of the Deutsche Edelstahlwerke combining the plants of seven concerns (January 1927). The outcome of the series of transactions was a very complicated system of financial and organizational interlocking between the different iron and steel combinations, but no attempt will be made here to display the complex relationships. In the midst of the movement there remained important independent elements, and the cartelized structure was maintained, headed by the Steel Works Associations (Stahlwerksverband) mentioned on page 256.[14]

In other branches of the metal industry (zinc, copper, and the like) the same tendency made headway. Of the heavy industries, lignite mining was practically the only one not to be affected by this sweeping movement. Thus, within a few years' time the structure of Germany's basic industries was completely reorganized and operations were brought to a very high state of efficiency.

[13] Originally the financial structure of this large combine was of the holding company type; later on (in the spring of 1934) an outright fusion took place by virtue of which the properties and assets of the firms concerned were transferred to a newly created joint stock company.

[14] This is not to be confused with the United Steel Works (Vereinigte Stahlwerke) which was a corporate combination.

International agreements concluded with competitive organizations abroad were instrumental in safeguarding the home market and, eventually, in allotting each partner to the convention adequate portions of the world's salable production. Such was the case with rails, steel ingots, potash, incandescent lamps, aluminum, various chemical goods, and others.

Strong cartelization of the basic industries was paralleled by efforts to develop for manufacturing industries specific types of combination suitable for coping with the powerful monopolistic tendencies in the markets of raw materials and semi-manufactured goods, or adapted to the needs of industries producing highly specialized commodities. The so-called "finishing" cartels established particularly in the machine-building trades owed their existence to this movement, in which combined action was used to promote standardization, rationalization, and productive efficiency.

It is a question still under discussion whether the rapid development of technically improved productive capacity was guided by a clear insight into the lasting conditions of the markets available for the output of German industry, and by adequate consideration of the peculiar nature of the sources of capital and credit supply which had been used in financing the development. However this may be, the first signs of a coming depression were noticeable as early as 1928 and led to a slowing down of general business activity. Crisis set in with the collapse of the American boom in the fall of 1929.

Cartelization now took a new rise and was applied to lines of industry in which attempts at market control had previously had little or no lasting success (clocks and ordinary watches, chinaware, bottle glass, linen thread, sugar, starch, and so on). Some industries in which competition was especially violent repeatedly asked for government interference to enforce agreements between the competitive concerns. Such was the

case with the manufacture of cigarettes and cement among other commodities.

To the extent that corporate combination was continued alongside of cartelization, under the pressure of restricted market and financial difficulties its "rationalizing" nature was even more accentuated than before, especially in the iron and steel industry. There appeared to be some tendency, also, to undo the effects of vertical combination, and to re-establish the commercial independence of each of the successive stages of processing.

1933 and After

Cartelization entered a new stage of development and came to exert a far more rigidifying effect on Germany's economy after the coming to power of the National-Socialist Government, in spite of repeated official declarations intended to discourage the spread of monopolist tendencies. Strong objections were raised against the view advanced by some representatives of the cartel movement that organization of industries initiated on cartel lines might be made fundamental to the new political constitution of the country. Representatives of National-Socialist economic reasoning pointed out that cartels resulting from purely economic tendencies could not be conceived as serving the purpose of relieving social tensions, which were to be removed by the establishment of a strongly united "national front" embracing employers as well as workers.[15] Moreover, the spirit of feudalism emphasized by the protagonists of the Third Reich against the capitalist spirit is said to be somewhat out of touch with economic sections which were the stronghold of cartelization, but to be mainly rooted in other spheres of activity represented by craftsmen and farmers. The changes of the economic structure which might result from a "flight into a cartelized econ-

[15] See R. Fricke, "Grenzen der Kartellwirtschaft," *Der Deutsche Volkswirt*, Dec. 7, 1933, Vol. VIII, No. 9, pp. 373 ff.

omy" have been considered by some National-Socialists to be detrimental to the national economy, especially if effected under the pressure of temporarily depressed business conditions.

In spite of such sentiments, up to the present the cartelization movement seems to have held the upper hand over any admonitions to the contrary. Consequent upon the general power invested in the government to control all lines of national activity, administrative supervision of combined action was enlarged by a law issued in July 1933 and the Minister of Economy was moreover authorized to enforce compulsory syndicates, conventions, and kindred agreements upon any groups of concerns for the purpose of market regulation. He was empowered to regulate the extent to which exploitation of productive capacity in certain trades might be permitted and to prohibit the establishment of new undertakings, as well as the expansion of business activity of existing ones.[16]

According to a report published by the German Institute for Business Cycle Research (in its *Wochenbericht* of December 6, 1933), between July and November 1933 about 30 cartels were reorganized, mainly by the inclusion of outsiders; and about 40 lines of industry changed from free competition to various systems of market control. Since regulation of production and prices had been very fully applied to raw materials, iron and steel, and chemicals during the depression years before 1933, cartelization after the coming of the National-Socialist government made new headway mainly in

[16] This step toward supervision and enforcement of cartels is entirely separate from the public organization (Organization der Gewerblichen Wirtschaft) which was organized to co-ordinate the functions of chambers of commerce and industry and chambers of handicraft, which had long had a semi-public status, and the functions of a purely private character exercised by bankers' associations and various industrial associations. Under this system, all business men were brought into a public organization, but the functions of the latter do not include market regulation of any sort.

manufacturing industries, and extended even to the production of finished goods such as leather goods and trunks, laces and embroideries, underwear, toys, and the like. Price-fixing was applied to more than half of the total industrial output of the country, leaving out of account the effects of fixed prices for basic materials upon prices at the later stages of production.

Cartelization received special incentives and new rules of conduct from the general economic policy for the protection of the independent small and medium size concerns against their better equipped competitors. Thus goods produced by small-scale establishments, and often sold on limited local markets, became favorite objects of market control (scythes, sea-grass, hemp and rope goods, slate boards, whetstones, tiles, and other construction materials, even playing-cards and the felt sheets put under beer glasses). But, what is more important, maintenance of small firms was made an integral part of cartel policy. Special concessions were made to the smaller concerns at the expense of larger ones. In the jute trade, for instance, restriction of production was graduated according to the size of the cartel members; it reached 30 per cent reduction of output for the large ones and was reduced by degrees to 10 per cent for the small ones. In other cases, as for instance in some lines of glass manufacture in which great divergences in technical processes produce marked differences in costs of production (up to 100 per cent), special compulsory regulation was introduced with a view to enabling antiquated technical methods to withstand the pressure exerted on them by new cost- and labor-saving devices. Efforts to create work for unemployed hands were also instrumental in modifying cartel policy. Works which had been closed down were reopened (in the glass and cement industry). In a word, the influences working toward the selective survival of the best-equipped plants were superseded by the tend-

ency to adapt regulation of prices and production to the needs of all those competing in the field of the cartelized trade, no regard being taken for their economic efficiency.[17]

Control of fixed prices, which had already been attempted by previous governments, was made the object of renewed efforts. In certain cases arousing public criticism, prices were declared illegal or cartels ordered to reduce prices within a given time. By decrees issued in May and August 1934 the fixing of new prices, especially when price increases were involved, required official approval to establish the validity of the prices. A price commissioner was appointed with practically unlimited powers to control commodity prices.

Simultaneously, compulsory regulation was applied to a considerable range of manufacturing industries, especially those directly or indirectly connected with the production of articles of food. This policy forms an integral part of the program to strengthen the agricultural basis of the country and to promote the independence of Germany's food supply from external markets. To this end, prices of agricultural products are to be freed from the movement of prices on the world market and are to be regulated in such a way as to secure the farmers adequate returns. In order to prevent manufacturers from disturbing such measures, and to protect small businesses against the superior competitive power of large concerns, strict regulation of output and prices was applied to the manufacture of agricultural products in general by virtue of a special law issued in September 1933.

Thus grinding of wheat and rye was made the object of a regulation extended over 24,000 mills, each of which was assigned a definite quantity of grain to be supplied by the farmers at minimum prices. Manufac-

[17] See "Kartellkonjunktur-Konjunkturkartelle," *Frankfurter Zeitung*, Dec. 17, 1933.

turing processes dealing with dairy products, fruit, and vegetables were likewise strictly regulated by measures including the reduction of productive capacity of existing plants, standardization of output, fixing of prices and price differentials, and the like. Eggs, butter, cheese, canned milk and fish, yeast, margarine, and chocolate goods were included in the scheme.

Compulsory regulation of production and prices in other than food manufacturing trades was not ruled by a definite plan, but has been resorted to whenever it was thought desirable. Such was the case with cement, soap, hollow glass, screws and wires, cigarettes, newsprint, radio apparatus, and other products. In a report[18] dated September 20, 1934 for the period covering the preceding eleven months, eleven industries are listed which were made the object of compulsory cartelization (not including food and allied trades), and thirty in which expansion of existing concerns and creation of new ones were prohibited. In many cases reopening of works was forbidden. In some cases where cartelization has not been forced upon the industry, outsiders have been compelled to observe the prices set by the cartel, though exempted from the quota schemes. Cost accounting has been made basic to the control of price-fixing. Concerns prevented from expanding their activity in their principal line have also been prohibited from embarking on allied lines, since such a procedure might have resulted in disorganizing other industries (such was the case with jute, paper, hollow glass, rolled-wire manufacture, and the like). In some industries restrictive measures reflect the increasing shortage of raw materials due to new trade barriers and difficulties on the foreign exchanges.

The National-Socialist government has been in power in a time of rather restricted markets. Only recently an expansionist movement has taken place in certain in-

[18] See *Frankfurter Zeitung*, Sept. 23, 1934 (Reichsausgabe).

dustries on the home market. What measures the government would attempt under other circumstances, it is idle to speculate upon. But that it should have adopted measures accentuating the tendency toward cartelization seems to confirm the view that depression periods furnish the primary setting for the development of cartelization.

GREAT BRITAIN

Profound changes in the role played by combinations of different types in the economic structure were brought about by the war and post-war disturbances in almost all industrialized European countries. This was especially true of Great Britain, which was in prewar time "as the stronghold of free trade and economic individualism considered to be permanently safeguarded against those monopolistic tendencies which were so marked a feature of foreign industry."[19]

Pre-War Conditions

Professor Levy, who has made extensive studies of monopolistic tendencies in British industry, scouts the commonly expressed view that the delayed and partial appearance of such tendencies reflects a peculiarly individualistic business psychology in Great Britain. "It was clearly not through any lack of will on the part of manufacturers that the powerful and effective cartels and trusts of Germany and the United States did not exist in England. That their efforts to carry out their desires were unavailing was the result of competition, either that of the foreigner or that which arose at home."[20]

The specific reasons for the maintenance of competitive conditions are summarized as follows: "Firstly

[19] Patrick Fitzgerald, *Industrial Combination in England*, London, 1927, p. 1.

[20] H. Levy, *Monopolies, Cartels and Trusts in British Industry*, 1927, p. 176.

England has no raw material in minerals possessing that monopoly in the world's market which favors the de velopment of cartels or trusts; and secondly precisely in the most important of the existing raw mineral products the conditions are most unfavorable for monopoly. On the other hand free trade is a sufficient explanation of the non-existence of cartels and trusts in a large section of English industries."[21]

Overwhelming weight must be attached to the last-named argument. Great Britain's industrial development for a century had been predicated upon expanding international trade opportunities throughout the world, with correlative freedom of access of external products to its own markets. Under these conditions, the possibility of monopolizing the home market was practically non-existent except in a very few fields. The idea of a market as a given quantum capable of being consciously divided among a number of allied concerns did not flourish under such circumstances. So long, therefore, as national economic policy was built upon a basis of international free trade, the scope of monopolistic combinations was severely limited.

In pre-war times, with varying success, attempts to control the market developed in a number of industries in which foreign competition was more or less eliminated, either by natural circumstances or by the specific character of the products. Among such industries, salt manufacture was the only one based on the exploitation of an inland mineral deposit. The creation of the "Salt Union" by amalgamating 64 firms dates back as far as 1888.

The most striking developments were in the field of corporate combinations. Among the most important combinations of at least semi-monopolistic character were those in the cement industry (1900, enlarged in 1912 and 1918); the whiskey distilling industry (1902–

[21] The same, p. 192.

07, enlarged in 1925); the tobacco industry (The Imperial Tobacco Co., 1901, combining 17 firms as a defensive measure against the American tobacco trust); the soap industry (Lever Brothers, a series of combinations after 1906); the wall-paper industry (before 1900, enlarged in 1915).

Favored by special conditions, a small number of organizations somewhat similar in character to American combinations developed in certain of the textile industries: the Fine Cotton Spinners and Doublers Combine formed in 1898, which incorporated about 40 firms; the combinations created in 1895–96 in the sewing-cotton trade bound by mutual agreements not to interfere with each other's business; the Dyers' Combine, created in 1898. The Calico Printers Combine formed in 1899 can hardly be reckoned in this group since it failed to achieve any monopolistic power.[22]

All these combinations were performed during a time of expansion of business activity covering the period April 1895–March 1900. Later pre-war expansion periods extended from October 1904–June 1907 and from October 1909–December 1912. Moreover, it is to be observed that this movement was almost exclusively limited to industries manufacturing consumers' goods or engaged on finishing processes.[23]

Combinations of a cartel-like type were almost nonexistent except for certain strictly regional markets protected by natural conditions against outside competition. Control over the national market was attempted only in isolated cases, mainly by certain branches of iron and steel manufacturing (such as rail-making, 1883, based on the prospects of an international agreement; steel making, 1901 and 1903; cast-iron pipes, 1908; cable making, 1898; the National Light Casting Asso-

[22] The data are taken from the elaborate study of P. Fitzgerald mentioned above.

[23] Levy, *Monopolies, Cartels and Trusts in British Industry*, p. 295.

ciation, 1911; and the Bedstead Makers Federation, 1912). Both of the last two combined price-fixing with a quota system and a pooling agreement.

Loose price associations were created and dissolved in considerable numbers, mainly, according to the Committee on Trusts, to exploit favorable business situations: ". . . the manufacturers come together as soon as possible when special circumstances make a rise of prices feasible, but not when over-production and difficulty of marketing their output at home and abroad are prevalent."[24]

Post-War Conditions

Extraordinary modifications of the system of free competition were brought about—or at least rapidly accelerated—by the abnormal conditions created by the war. Side by side with this development public opinion, economic reasoning, and official judgment underwent a widespread change of attitude towards the combination movement. The formation of corporate combinations on the one hand and of loose price associations on the other was largely stimulated by inflated monetary conditions which obtained during the war and continued during the short post-war boom. In the official report of the Committee on Trusts issued in 1919, no less than 93 combinations—cartels, syndicates, and loose associations—are listed, most of them of a rather regional character. Extensive corporate combination took place in the iron and steel industry (pig iron, raw steel, rolling mills, cast steel, wrought iron, bar iron, and so on). The two great firms of Vickers, Ltd. and Armstrong, Whitworth and Company afford striking illustrations of amalgamations promoted by currency inflation. Very few of the combinations during the period were strictly of cartel type.

[24] *Report of Committee on Trusts*, Ministry of Reconstruction (Cd. 9236), 1919.

The Committee on Trusts set up to investigate the results of this development arrived at a notable conclusion: "We are satisfied that trade associations and combines are rapidly increasing in this country, and may within no distant period exercise a paramount control over all important branches of British trade."[25] This expectation was, however, but slightly fulfilled during the years immediately following. The ensuing depression, "unprecedented in the history of industry led quickly to the disruption of many associations and involved even the strongest combines into serious troubles."[26]

British trade was relatively depressed through most of the decade after 1920. The British export industries had definitely lost a large part of their outlets, which made a high rate of permanent unemployment a characteristic feature of post-war British economy. To what extent this situation was aggravated by the monetary policy embarked upon by restoring the currency to gold parity in 1925 is not to be discussed here. This much may be said, that a deflationist tendency was ruling up to the autumn of 1932, when Great Britain went off the gold standard.

These conditions were not favorable to corporate combinations, and the latter were mostly limited to lines of industry in which technical improvements and new processes of production were instrumental in promoting the creation of large managerial or financial units. The outstanding example in this field was the establishment in October 1926 of the Imperial Chemical Industries, Ltd., formed by the combination of Brunner Mond with three other leading concerns. Outright consolidation was of some importance in building up larger concerns in various branches of the iron and steel industry. But, owing to the absence of monopolistic control of raw materials, the economic urgency of vertical

[25] The same.

[26] See Fitzgerald, *Industrial Combination in England*, p. 2.

concentration and integration was not imperative and the existence of large mixed works did not force the remaining undertakings to follow this example.[27] In other industries equally marked by monopolistic tendencies (such as yeast and rayon manufacturing, oil distribution, meat importing) expansion of existing concerns was less due to amalgamation than to "a general process of internal development on the part of the few original firms."[28]

Other industries in which monopolistic control of the market, already prevalent in pre-war times, was in existence can hardly be said to form the backbone of the national economy. Such was the case with cotton thread, calico prints, dyeing, matches, cement, tobacco, industrial alcohol, soap, and explosives.

The following view of the situation as it existed in 1927 was expressed by Fitzgerald:

> Though concentration of ownership has reached an advanced stage, in no section of the industry has it developed so far as to give any undertaking a monopoly, or, with one or two possible exceptions, even predominance. But by reducing the number of rival enterprises and raising obstacles against new ones, it has greatly facilitated the formation of price-fixing associations. . . . Some of them are informal, bound only by tacit agreements; others are highly organized; all are alike in that they lack permanence or at least the power to maintain for long periods a really effective control.[29]

The long-continued depression has operated to make inroads upon the free trade policy which blocked the way to cartelization. Loss of markets abroad was instrumental in reviving schemes for preferential trade agreements within the British Empire. Moreover, attention was centered on the possible expansion of the home market, which had not previously been made

[27] Levy, *Monopolies, Cartels and Trusts in British Industry*, p. 223.
[28] Fitzgerald, *Industrial Combination in England*, p. 2.
[29] The same, p. 41.

the object of deliberate economic policy. By official, semi-official, and private inquiries, development of this market was stressed as the most propitious measure for combating unemployment. The main obstacle barring the way to the conception of this market as a single entity, capable of being divided among domestic producers, was removed by the abolition of free trade in 1931 and the erection of new tariff barriers. Revenues from customs duties were an important consideration in adopting the new policy. But the restriction of British outlets on foreign markets must be regarded as the primary condition underlying so remarkable a change in British trade policy.

The circumstances connected with the desertion of free trade policy equally furnished the basis for popularizing the idea of combined action. Not only were industrial groups made actively conscious of the possible merits of cartel-like combinations, but also the subject was brought to the public at large through popular discussion. As Mr. Marquand says:

> The depression has proved to be so chronic that it is now having the effect of encouraging cartelization. The blind optimism which saw at the turn of every year signs of a "trade revival" has vanished. It is admitted on every hand that mere optimism is not sufficient, and that the repetition of the mystic words "trade cycle" does not in itself ensure that a long slump is bound to be followed by a boom.[30]

The need for industrial organization and controlled competition as means of improving the productive mechanism of British industry has been stressed by the Liberal industrial inquiry "Britain's Industrial Future," by the official report of the Committee on Industry and Trade, and by various reports made upon special industries (coal mining, cotton, iron and steel).

To date, the developments have been mainly in the

[30] H. A. Marquand, *The Dynamics of Industrial Combination*, 1931, p. 11.

formative change of sentiment. Tendencies toward combined action through industrial associations have been increasing, but have not as yet developed into a real cartel movement. In shipbuilding and flour milling, since 1930 and 1929 respectively, competition has been successfully reduced by the adoption of schemes for purchasing and dismantling obsolete plants and thus reducing surplus productive capacity. On the other hand, voluntary agreements for strictly controlling output by allocating to each member a fixed percentage or quota of the total production have been effected in only a few industries (nitrate, tin-plate, galvanized sheets, white lead and red lead). Combinations providing for a common selling agency are rather rare exceptions. Where in existence, as in the case of the Sulphate of Ammonia Federation, they do not have resort to a clearly defined quota system or formal control of output. In one of the most important fields of economic activity, in the spinning and weaving lines of the textile industry repeated attempts to restrict output—by all-round short-time schemes and price-fixing—have invariably failed to attain their objectives.

The government has taken action in the direction of compulsory cartelization in the coal-mining industry. Trade agreements paving the way for concerted restriction of output were forced upon the reluctant mine owners by virtue of legal provisions which aimed at combining all mines eventually into a national super-cartel, to which regional cartels were to be subordinated. But no sweeping reform of the industry has yet been achieved. Action was also taken concerning the steel industry in 1934 to the extent of making added tariff protection conditional upon some sort of combined action by the industry to regulate competitive conditions. The proposals adopted by the industry early in 1934 call for the organization of the entire industry into not more than twelve divisions, vamped upon a sectional

rather than a regional line. Autonomous associations are to be charged, under the supervision of a national federation, with controlling prices and output, promoting combination, reducing excess capacity, and with other measures of reconstruction including participation in international cartel agreements.[31]

Quite recently (June 1935), after various voluntary schemes had met with failure, a bill was submitted to the British Parliament directed toward reducing the volume of spindles in operation in the cotton industry (44 millions) by a scheme providing for scrapping 10 millions. The costs involved in this scheme (2 million pounds) are to be borne by contributions collected from the cotton spinners and extended over a period of 15 years. But nothing approaching a general stimulation of collective action for control of the market as yet characterizes the economic policy of the British government.

Thus British experience is apt to convey a picture of the obstacles to be overcome by a cartelization movement rather than of the circumstances promoting its development.[32] The adoption of a tariff policy under which cartelization could make headway is very recent; the economy of the country is still dominated by international trade relationships built up under a system of free trade; and both national policy and the interests of many important industries are still oriented on foreign rather than domestic markets. So long as this situation continues—and it may be permanent—conditions are not propitious for the widespread develop-

[31] See A. F. Lucas, "The British Movement for Industrial Reconstruction," *Quarterly Journal of Economics*, February 1935, p. 212.

[32] "If British experience teaches us nothing more, it has at least demonstrated the inherent difficulties of minutely regulating prices, of imposing rigid restraints upon the productive activity of individual enterprises, of manipulating total output to meet fluctuations in the demand, and of concentrating output in the most efficient firms—all of which are essential functions of a strong, inclusive and permanent program of control." The same, p. 233.

ment of cartelization. But it can be confidently stated that an important effect of the long depression has been to turn business and public sentiment in the direction of cartelizing tendencies.

FRANCE

The combination movement in France is marked by a prolonged struggle over the official acknowledgment of cartelization. Though by Article 419 of the Penal Code enacted in 1870 any concerted action for the purpose of influencing prices was declared a criminal offense, the creation of cartel-like combinations met with few obstacles, thanks to a liberal interpretation of the legal provisions. This latitude of action was expressly sanctioned in 1926 by a supplementary law according to which combinations are considered lawful if intended to secure their members "normal" profits. By common opinion organizations meant to protect their members against losses resulting from ruinous competition are considered defensive and not monopolistic in nature.[33]

The "*comptoir*" is the specific cartel-form brought about by the French cartelization movement. It is an incorporated company established for the purpose of regulating production and prices in the industry concerned. This may be done by the creation of a common selling agency; by regional distribution of the market over the members; by price-fixing; by restricting the total output of the trade through a quota system; by providing for outlets on external markets. Combinations following these lines of action had developed before the war, especially in the pig-iron and the iron and steel industry, in some lines of the chemical industry, in the plate-glass industry, in the salt industry, and in a few others. As a rule the influence of the central body on

[33] An account of the proposals out of which this legislation grew, and of the supporting arguments, is given in I. Lapergue, *Les Syndicats de Producteurs en France*, 1925.

common policy was much weaker than with German cartels. M. Lapergue states that periods of crisis impairing the balance between productive capacity and markets were instrumental in generating *comptoirs*.[34]

Of much less importance but far greater in number is another type of combination known as "commercial association." The members are obliged to report their orders and sales to a central agency. Price-fixing in the manner of open-price associations and assignment of sales districts are the essential functions of these organizations.

Before the war, French economy was characterized by the prevalence of finishing trades as compared with basic industries; small and medium size undertakings were predominant. Thus, in spite of the economic strength of the country, which was largely due to the saving capacity of its population, the combination movement was rather slow in progress.

A profound change in French economy followed the annexation of Alsace-Lorraine and the economic occupation of the Saar district of Germany. In important lines of the iron and steel industry French undertakings became strong competitors on the world market, the more so as the home market did not display important tendencies towards expansion. This additional capacity in the French heavy industry stimulated cartelization.

At the same time the circumstances attending inflation, before the currency stabilization in 1926, were conducive to corporate combinations. The outstanding example of vertical combination extending over a large range of processes of production is that of the Schneider concern in the iron and steel and armament industries, with the old firm of Le Creusot as its base. It is paralleled in the electro-technical industry by the Thomson-Houston concern and in the chemical industry by the Pechiney concern. These powerful integrated combina-

[34] The same, p. 165.

tions are strong enough to pursue isolated production and price policies. The creation of holding companies is preparing the way for a considerable degree of monopolistic control.

In the field of cartel-like agreements, lack of sufficient markets at profitable prices for the products of the mining and the iron and steel industries was instrumental in the re-establishment of some *comptoirs* which had lost their essential functions during the war, and in the creation of new ones. But it is interesting to note that some cartels of the iron and steel industry were dissolved during the years 1921 and 1922; among them was the cast-iron cartel (Comptoir de Longwy) which was of old standing, the sheet-iron and slabs cartel (Comptoir des Tôles et larges plats), the iron foundries' cartel created especially for organizing the export trade (Comptoir Sidérurgique).[35]

The general character of developments in the iron and steel industry have been described as follows by Sir R. Cahill: "The tendency has therefore been towards various forms of combination for limited objects, either corporatively organized or arranged through mingling of participations and persons or by agreements, the full vitality of the allied parties being safeguarded."[36] There are in existence several cartels and price associations in the coal-mining industries, others controlling various lines of production of ore, iron and steel, raw iron, band iron, bar iron, angle iron, girders, rails, tubes, etc. The Lorraine iron and steel concerns succeeded in organizing control of their production and sales at home and abroad through nine separate *comptoirs* for separate classes of crude and semi-finished

[35] Whether or not this was for reasons connected with the then existing state of inflation cannot be stated here since the special circumstances surrounding the dissolution of these *comptoirs* are not known to the author.

[36] "Economic Conditions in France," *Department of Oversea Trade No. 581*, London, 1934, p. 665.

products. Important *comptoirs* have centered their activity on export purposes. "One of the great services rendered by these *comptoirs* has been to allow French metallurgists and constructors to accept jointly certain orders from foreign countries which, owing to their size, no single enterprise could have undertaken to carry out."[37]

More or less loose price and production agreements exist in the chemical industry, in the sugar industry, and in several branches of the textile industries. In the cotton and rayon industries common selling is organized by syndicates. Monopolistic organization of potash production can hardly be said to be established on cartel lines, since two-thirds of the mines are owned by the state and one-third by a company.

The essential cartelization problems of French industry may be said to be connected not with the home market, but with the export interests as they were influenced by the conditions of the annexed territories. "Concentration and rationalization, involving the centralization of initiative and control for whole industries of great magnitude or for vast fractions thereof, is alien to the special character of a large proportion of the most characteristic French productions, has not been deemed universally desirable, nor, indeed, completely or advantageously realizable in numerous cases (for example, coal, metallurgy, silk, woolen, cotton, dressmaking, machine-tools, and so forth)."[38] The difficulty of securing outlets for the newly accrued export branches of heavy industries is the prime motive in stimulating cartelization, the more so by reason of the adverse factors impairing world trade since the end of the war. As a matter of fact, certain French combinations were mainly created with a view to participating in international cartel agreements, especially of the

[37] P. de Rousiers, *Cartels and Trusts*, Ser. L. o. N. P., 1927, II, 21, p. 17.
[38] *Economic Conditions in France*, p. 664.

iron and steel industry (steel ingots, tubes, rolled wires, machine wires) and of the chemical industry.

It is thus easy to understand that at the World Economic Conference held at Geneva in 1927 the idea of stabilizing international competitive conditions by a network of international cartel agreements was strongly supported by the French delegates, and—apart from favorable economic effects—credited with the merit of promoting political *rapprochements* among European nations. French export interests also played an important role in the recent legislative action which may result in introducing compulsory cartelization into the economic system.[39] It remains to be seen whether the practical effects of this action will be of a nature to justify the high expectations of some of its advocates.

OTHER COUNTRIES

In Italy for many decades development of cartelization was rather slow as compared with other countries. Various reasons are advanced to explain this phenomenon: lack of natural resources like coal and iron, which are basic to the creation of large concerns equipped with heavy capital investments and especially sensitive to market fluctuations; prevalence of small and medium sized undertakings in which payrolls constitute the principal cost element; individualistic tendencies on the part of employers which render them rather ill disposed to combined action.[40] Thus in 1906 when Sicilian sulphur production was threatened by a dangerous crisis, unwillingness on the part of the mine owners to agree on restriction of production was so great that a cartel was forced upon the reluctant trade only by virtue of special legislation. Voluntary agreements with a view to regulating production were concluded in the silk in-

[39] See p. 168.
[40] F. Vito, *I Sindacati Industriali*, 1932, p. 292.

dustry, the match industry, and, above all, in branches of iron and steel fabrication.

Immediately after the war a wave of corporate combination was accelerated by circumstances of monetary inflation. This increased concentration of control facilitated the spread of cartelization when at a later period it was induced by declining prices, credit restrictions, international trade barriers, and disturbances of the international financial structure. The desire to establish strong control over the home market was paralleled in important industries by the prospect of using cartels as instruments for international industrial agreements. Cartelization developed in the iron and steel industry, in shipbuilding, in cement, cotton, chemical, paper, wood manufacturing, and elsewhere. Cartels were forced upon the marble quarries of Carrara, the rolling mills, and the sulphur mines.

The effects of the new Fascist policy of compulsory cartelization, mentioned in Chapter VI, have been rather slow in development. Apart from the iron and steel industry, cotton and silk are the principal trades which have been affected by the new order. In some cases cartel functions have been extended, by virtue of legal provisions, to the task of financing production and sales of the industries concerned. Such was the case with the sulphur industry, for which an official joint selling agency was provided in December 1933. In the case of silk, a system of financing the industry with the backing of a large group of insurance and savings institutions was introduced.

It would lead too far afield to discuss the cartelization movement of other countries.[41] Though following tendencies which developed in pre-war times, this movement has been especially accentuated in the succession states of the Austrian Empire, Austria and

[41] See mainly P. T. Fischer and H. Wagenfuhr, *Kartelle in Europa*, 1929.

Czechoslovakia, and in Poland and Switzerland. Its essential features are the same throughout all industrialized countries; its specific aspects are due to the conditions of the national economies concerned.

Thus the importance of cartels is much greater in a country, like Czechoslovakia, which is relatively rich in basic industries (coal, iron, and steel). In Austria, in spite of strong tendencies towards cartelization, the striking maladjustments growing out of the partition of the Empire and the peculiar poverty of the home market have made it very difficult to pursue the normal lines of cartel policy consistently. To be successful, cartel agreements commonly have to be "international" agreements, which in numerous cases are but understandings between concerns which formerly belonged to the same system of national economy. In Switzerland, cartelization—apart from the cement, limestone, and brick industries—hardly applies to capital producing industries, but mainly to textile and food manufacture, and is split up in many localized organizations controlling limited regional markets.

In Poland, cartelization is in rapid progress, promoted by official economic policy, especially for the purpose of preparing the way for increased exports. Thus strongly organized cartels of the "syndicate" type were created during the last decade in the coal-mining industry, the iron and steel industry, the metal fabricating and chemical industries.

The Belgian cartelization movement dates back to the last century but its monopolistic tendencies were checked by the free trade system adopted in 1865. In recent times the conditions of international trade have provided new incentives for this movement, especially in the basic industries, and certain steps toward compulsory cartelization have been taken. Cartel-like combinations in the Scandinavian countries have also arisen mainly in connection with the circumstances of certain export trades.

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